No. 14785

United States
Court of Appeals
for the Ninth Circuit

WEYL-ZUCKERMAN & COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of Record

Petition to Review a Decision of The Tax Court
of the United States

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif. —9-9-55

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF ATTORNEYS

DAVID LIVINGSTON and
LOUIS F. DI RESTA,
Russ Bldg., San Francisco, Calif.,

Counsel for Petitioner.

H. BRIAN HOLLAND,
Assistant Attorney General,

ELLIS N. SLACK,
Special Asst. to Attorney General,
Dept. of Justice, Washington, D. C.,

JOHN POTTS BARNES,
Chief Counsel,

CLAUDE R. MARSHALL,
Special Attorney, Internal Revenue Service,
Washington 25, D. C.,

CHARLES W. NYQUIST,
Chief Counsel, Bureau of Internal Revenue,
Counsel for Respondent.

The Tax Court of the United States

Docket No. 43504

WEYL-ZUCKERMAN & COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1952

Aug. 18—Petition received and filed. Taxpayer notified. Fee paid.

Aug. 20—Copy of petition served on General Counsel.

Aug. 18—Request for Circuit hearing in San Francisco, Calif., filed by taxpayer. Granted—9/2/52.

Sept. 30—Answer filed by General Counsel.

Oct. 8—Copy of answer served on taxpayer—San Francisco, Calif.

1953

Dec. 22—Hearing set March 22, 1954, San Francisco, Calif.

1954

Mar. 17 and 18—Hearing had before Judge Raum on the merits. Stipulation of Facts and exhibits 1A through 2B, filed at hearing. Petitioner's Brief due 5/3/54; Respondent's Brief due 6/2/54; Petitioner's Reply due 6/22/54.

Apr. 5—Transcript of Hearing 3/17/54 filed.

1954

Apr. 5—Transcript of Hearing 3/18/54 filed.

May 3—Brief filed by taxpayer. Copy served.

June 2—Brief in answer filed by General Counsel. 6/3/54—Copy served.

June 17—Motion for extension of time to July 22, 1954 to file reply brief filed by taxpayer. Granted—6/17/54.

July 15—Motion for extension of time to Aug. 22, 1954 to file reply brief filed by taxpayer. Granted—7/16/54.

Aug. 25—Reply brief filed by taxpayer. Copy served —8/26/54.

1955

Feb. 14—Findings of Fact and Opinion filed, Judge Raum, Decision will be entered for the respondent. Copy served 2/14/55.

Feb. 15—Decision entered. Judge Raum, Div. 11.

May 11—Petition for review by U.S. Court of Appeals for the Ninth Circuit with assignments of error filed by taxpayer.

May 13—Proof of Service filed.

May 13—Designation of Contents of record with affidavit of service by mail attached, filed.

May 23—Designation for Additional Portions of Record with proof of Service by mail thereon, filed by General Counsel.

[Title of Tax Court and Cause.]

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency, IRA:90-D:HVH (C:AS:PD SF:HGP), dated May 22, 1952, and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation organized under the laws of the State of California, with its principal office at 146 West Weber Avenue, Stockton 2, California. The returns for the periods here involved were filed with the Collector of Internal Revenue for the First District of California.

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to the petitioner on May 22, 1952.

3. The Commissioner determined an overassessment in income tax for the calendar year 1946 in the amount of $6,773.28 and a deficiency in income tax for the calendar year 1947 in the amount of $66,082.54; of these amounts the following are in controversy:

Year	Amount	
1946	$11,843.60	Overassessment
1947	57,363.75	Deficiency

4. The determination of taxes set forth in said notice of deficiency is based upon the following errors:

(a) The Commissioner erred in holding by implication that petitioner was the owner of mineral rights on the property known as Henning Tract at all times prior to December 21, 1946.

(b) The Commissioner erred in holding that the petitioner had not received from its wholly-owned subsidiary, McDonald Island Farms, Ltd., on December 21, 1946 a dividend in kind, consisting of certain mineral and gas rights, which had a fair market value of $230,000.00.

(c) The Commissioner erred in failing to hold that up until December 21, 1946 McDonald Island Farms, Ltd., was the owner of said mineral rights; that on December 21, 1946 McDonald Island Farms, Ltd. declared a dividend in kind consisting of said rights and transferred them to petitioner; that on said date petitioner received said rights as such dividend; and that on said date said rights had a fair market value of $230,000.00.

(d) As a result of the error assigned in subparagraph (a) above, the Commissioner erred in determining that the petitioner's royalty income for the calendar year 1946 should be increased in the amount of $5,602.08.

(e) As a result of the errors assigned in subparagraphs (a) and (d) above, the Commissioner erred in determining that the petitioner was entitled to an additional allowance for depletion for the calendar year 1946 in the amount of $1,136.42.

(f) As a result of the errors assigned in subparagraphs (b) to (e) above, inclusive, the Commis-

sioner erred in determining that the petitioner had additional long-term capital gain income for the calendar year 1947 in the amount of $229,455.00 from the sale of its mineral and gas rights.

(g) The Commissioner erred in determining a deficiency against the petitioner for the calendar year 1947 and an overassessment on the petitioner for the calendar year 1946.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) At all times from June 27, 1946 to December 21, 1946, McDonald Island Farms, Ltd., a corporation, hereinafter called McDonald Ltd., was the owner in fee simple of the property located in the Delta District of the San Joaquin River in San Joaquin County, known as Henning Tract.

(b) On December 21, 1946, McDonald Ltd. declared a dividend of all mineral rights on said Henning Tract. Said mineral rights are those which are involved in the determination of the Commissioner as hereinabove set forth. On said date petitioner was the owner of all the issued and outstanding stock of McDonald Ltd. and pursuant to said dividend McDonald Ltd. conveyed said rights to petitioner.

(c) Said dividend was declared and said conveyance was made in the regular course of business of McDonald Ltd. and for valid and legitimate business purposes.

(d) Petitioner reported said dividend in its income tax return for the year 1946 at a fair mar-

ket value thereof, to wit, $230,000, and paid taxes thereon.

(e) On January 20, 1947 petitioner sold to Pacific Oil Company (California), a corporation, a portion of said mineral rights. Said sale was a part of the transaction involving the sale of mineral rights on other property. The total purchase price of all of said mineral rights was $609,514.46. The portion of said purchase price allocated to the mineral rights received by petitioner as such dividend was $230,000.00.

(f) No gain resulted from the sale of said mineral rights on Henning Tract.

Wherefore, the petitioner prays that the Court may hear the proceeding and determine:

(1) That at all times from June 27, 1946 to December 21, 1946 McDonald Island Farms, Ltd. was the owner in fee simple of the property known as Henning Tract.

(2) That the petitioner received from McDonald Island Farms, Ltd. on December 21, 1946 a dividend in kind of certain mineral rights which had a fair market value of $230,000.00.

(3) That the petitioner did not have additional royalty income for the year 1946, and likewise was not entitled to an additional allowance for depletion for that year.

(4) That the petitioner did not have additional capital gain income from the sale of its mineral rights in the year 1947.

(5) That there is no overassessment due to peti-

tioner for the year 1946 and that there is no deficiency due by petitioner for the year 1947.

Respectfully submitted,

/s/ DAVID LIVINGSTON,
/s/ P. K. WEBSTER,
Counsel for Petitioner

August 12, 1952, San Francisco, California.

Duly Verified.

EXHIBIT "A"

U. S. Treasury Department, Office of Internal Revenue Agent in Charge, 74 New Montgomery St., San Francisco 5, California May 22, 1952

San Francisco IRA:90-D:HVH (C:AS:PD SF: HGP)

Weyl-Zuckerman & Company
146 West Weber Avenue, Stockton 4, California

Gentlemen:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1947 discloses a deficiency of $66,082.54, and that the determination of your income tax liability for the taxable years ended December 31, 1944 and December 31, 1946 discloses an overassessment of $6,795.23, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of

this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia, in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to this office for the attention of IRA:90-D. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Very truly yours,

JOHN B. DUNLAP,
Commissioner,

/s/ By F. M. HARLESS,
Internal Revenue Agent in Charge

Enclosures: Statement, Form 1276, Agreement Form.

Statement

Tax Liability for the Taxable Years Ended December 31, 1944, December 31, 1946 and December 31, 1947.

Year Ended	Liability	Assessed	Over-assessment	Deficiency
		Income Tax		
Dec. 31, 1944	$ 78,843.26	$ 78,865.21	$ 21.95	
Dec. 31, 1946	20,543.45	27,316.73	6,773.28	
Dec. 31, 1947	114,051.49	47,968.95		$66,082.54
Totals	$213,438.20	$154,150.89	$6,795.23	$66,082.54
		Excess Profits Tax		
Dec. 31, 1944	None	None	None	None

In making this determination of your income and excess profits tax liability, careful consideration has been given to your protest filed January 9, 1950; to the statements made at the conferences held on March 7, 1950 and December 14, 1951; and to your claims for refund filed on May 26, 1947, July 29, 1949 and June 28, 1950 for the year 1944 and your claim for refund filed on June 28, 1950 for the year 1946.

It is noted that on August 11, 1949 you filed an application for relief under section 722 of the Internal Revenue Code for the year 1944 on form 991. The entire amount of excess profits tax disclosed by your 1944 excess profits tax return was the subject of an overassessment based on allowance of an excess profits credit carry-back from the year 1946 as claimed on forms 843 and 1139 filed by you on May 26, 1947. Since you have no excess profits tax liability for the year 1944, form 991 filed by you does not constitute a claim for refund.

The overassessment shown herein for the year 1946 should not be regarded as finally determined. When final determination has been made, the overassessment, to the extent of the amount allowable, will be made the subject of a Certificate of Overassessment which will reach you in due course through the office of the Collector of Internal Revenue for your district and will be applied by that official in accordance with section 322(a) of the Internal Revenue Code.

A copy of this letter and statement has been mailed to your representative, Mr. P. K. Webster, Haskins and Sells, 155 Montgomery Street, San Francisco, California, in accordance with the authority contained in the power of attorney executed by you and on file in this office.

ADJUSTMENTS TO NET INCOME

Year: 1944

Net income for declared value excess profits tax computation as disclosed by return	$210,648.69
Nontaxable income and additional deductions:	
(a) California franchise tax	54.89
Net income for declared value excess profits tax computation as adjusted	$210,593.80

EXPLANATION OF ADJUSTMENTS

(a) An additional deduction of $54.89 for California franchise tax is allowed as follows:

Increase in 1943 income due to adjustment of Capital Stock tax	$ 1,875.00
Percentage of business done within the State of California as disclosed by your franchise tax return	86.11%
86.11% of $1,875.00	$ 1,614.56
Franchise tax—85% of 4% of $1,614.56 or	$ 54.89

COMPUTATION OF DECLARED VALUE EXCESS PROFITS TAX—Year: 1944

Net income for declared value excess profits tax computation		$210,593.80
Less: 10% of $3,000,000.00, value of capital stock as declared in your capital stock tax return for the year ended June 30, 1944	$300,000.00	
Dividends received credit	11,050.00	311,050.00
Balance subject to declared value excess profits tax		None
Total declared value excess profits tax assessable		None
Total declared value excess profits tax assessed:		
Original, Account No. 410451, June 1945 list, First California District		None
Deficiency or overassessment of declared value excess profits tax		None

COMPUTATION OF TAX

Year: 1944

Net income for declared value excess profits tax computation		$210,593.80
Less: Dividends received credit		11,050.00
Normal tax and surtax net income		$199,543.80
Alternative tax:		
Normal tax and surtax net income		$199,543.80
Less: Net long-term capital gain		6,495.06
Adjusted normal tax and surtax net income		$193,048.74
Normal tax at 24% on $193,048.74		$ 46,331.70
Surtax at 16% on $193,048.74		30,887.80
Total normal tax and surtax		$ 77,219.50
Add: 25% of net long-term capital gain		1,623.76
Alternative tax		$ 78,843.26
Tax at ordinary rates:		
Normal tax at 24% on $199,543.80		$ 47,890.51
Surtax at 16% on $199,543.80		31,927.01
Income tax at ordinary rates		$ 79,817.52

Income tax liability (alternative tax)		$ 78,843.26
Income tax assessed:		
Original, Account No. 410451, June 1945 list First California District	$47,610.94	
Additional, July 25, 1947 Special List No. 7	31,254.27	78,865.21
Overassessment of income tax		$ 21.95

EXCESS PROFITS NET INCOME
Year: 1944

Excess profits net income under the income credit method, as disclosed by your return	$191,153.63
Nontaxable income and additional deductions:	
Additional California franchise tax as disclosed by the foregoing	54.89
Excess profits net income under the income credit method, as adjusted	$191,098.74

COMPUTATION OF EXCESS PROFITS TAX
Year: 1944

Excess profits net income		$191,098.74
Less: Specific exemption	$ 10,000.00	
Excess profits credit, under the income credit method, as disclosed by your return	103,017.96	
Unused excess profits credit carry-back (under the income credit method) as disclosed by claim filed July 29, 1949	102,595.67	215,613.63
Adjusted excess profits net income		None
Excess profits tax liability		None
Excess profits tax assessed:		
Original, Account No. 400335, June 1945 list First California district	$ 66,806.00	
Less: Tentative allowance	66,806.00	None
Deficiency or overassessment of excess profits tax		None

ADJUSTMENTS TO NET INCOME

Year: 1946

Net income as disclosed by return		$458,579.97
Unallowable deductions and additional income:		
(a) Depreciation allowance decreased	$ 13,342.94	
(b) Royalty income increased	5,602.08	18,945.02
Total		$477,524.99
Nontaxable income and additional deductions:		
(c) Depletion increased	$ 1,136.42	
(d) Dividends	230,000.00	231,136.42
Net income as adjusted		$246,388.57

EXPLANATION OF ADJUSTMENTS

(a) The depreciation allowance is decreased $13,342.94 as follows:

	As Disclosed By Return	As Adjusted
Farm buildings, Utah	$ 523.47	$ 435.79
Potato cellar, Utah	2,926.65	1,624.29
Potato cellar, Hosley	1,795.86	996.70
Office building, Stockton	250.00	125.00
Farm implements, Hosley	4,831.90	2,174.35
Farm implements, Utah	14,225.01	6,401.25
Machine shop equipment, Utah	1,094.86	547.43
Total	$ 25,647.75	$ 12,304.81

Depreciation disclosed by return	$ 25,647.75
Depreciation as adjusted	12,304.81
Decrease in depreciation allowance	$ 13,342.94

(b) Your taxable income is increased $5,602.08 representing your share of royalty income from the Henning Tract for the period June 26, 1946 to December 20, 1946.

(c) Depletion allowance is increased $1,136.42 as follows:

Amount allowed	$ 18,688.21
Amount claimed on your return	17,551.79
Increase	$ 1,136.42

(d) You included in dividend income for the year 1946 the amount of $230,000.00 alleged to be the fair market value of mineral and gas rights reported by you as received in 1946. (See explanation of adjustments for the year 1947.) Dividend income for the year 1946 is decreased by this amount.

COMPUTATION OF INCOME TAX
Year: 1946

Net income			$246,388.57
Less: Dividends received credit			187,000.00
Normal tax and surtax net income			$ 59,388.57
Alternative tax:			
Normal tax and surtax net income			$ 59,388.57
Less: Excess of net long-term capital gain over net short-term capital loss			12,258.88
Adjusted normal tax and surtax net income			$ 47,129.69
Normal tax:			
Tax at 15% on	$ 5,000.00	$ 750.00	
Tax at 17% on	15,000.00	2,550.00	
Tax at 19% on	5,000.00	950.00	
Tax at 31% on	22.129.69	6,860.20	
Tax on	$47,129.69	$11,110.20	$ 11,110.20
Surtax:			
Tax at 6% on	$25,000.00	$ 1,500.00	
Tax at 22% on	22,129.69	4,868.53	
Tax on	$47,129.69	$ 6,368.53	6,368.53
Normal tax and surtax			$ 17,478.73
Add: 25% of net long-term capital gain			3,064.72
Alternative tax			$ 20,543.45
Tax at ordinary rates:			
Normal tax at 24% on $59,388.57			$ 14,253.26
Surtax at 14% on $59,388.57			8,314.40
Income tax at ordinary rates			$ 22,567.66
Income tax liability (alternative tax)			$ 20,543.45

Income tax assessed:	
Original, Account No. 410418	
June 1947 list	
First California District	27,316.73
Overassessment of income tax	$ 6,773.28

ADJUSTMENTS TO NET INCOME
Year: 1947

Net income as disclosed by return		$210,502.58
Unallowable deductions and additional income:		
(a) Depreciation allowance decreased	$ 16,450.56	
(b) Long-term capital gain	229,455.00	245,905.56
Net income as adjusted		$456,408.14

EXPLANATION OF ADJUSTMENTS

(a) The depreciation allowance is decreased $16,450.56 as follows:

	As Disclosed By Return	As Adjusted
Farm buildings, Utah	$ 4,599.50	$ 3,829.08
Potato cellar, Utah	6,082.02	3,375.52
Potato cellar, Hosley	1,795.86	996.70
Office building, Stockton	250.00	125.00
Farm implements, California	37.08	16.69
Farm implements, Hosley	4,935.82	2,221.12
Farm implements, Utah	15,818.32	7,118.24
Machine shop equipment, Utah	1,228.61	614.30
Totals	$ 34,747.21	$ 18,296.65

Depreciation as disclosed by return	$ 34,747.21
Depreciation as adjusted	18,296.65
Decrease in depreciation allowance	$ 16,450.56

(b) It is held that in the determination of long-term capital gain from the sale of mineral and gas rights in 1947, the corrected gain properly reportable is $386,513.63 instead of the amount

of $157,058.63 reported in your return. The corrected gain of $386,513.63 is computed as follows:

Gross sales price of mineral and gas rights		$609,514.46
Cost of mineral and gas rights sold:		
Cost of McDonald Tract:		
Dividend acquired March 13, 1946	$120,000.00	
Acquired by purchase from Holly Sugar Corporation	118,666.28	
Total cost	$238,666.28	
Less: Depletion allowable	15,665.45	
Net cost of McDonald Tract	$223,000.83	
Cost of Henning Tract	None	223,000.83
Long-term capital gain corrected		$386,513.63
Long-term capital gain reported		157,058.63
Increase in long-term capital gain		$229,455.00

In the determination of the above gain, the dividend in kind—mineral and gas rights—supposedly received by you on or about December 26, 1946, from your wholly-owned subsidiary, McDonald Island Farms, Ltd., at an asserted fair market value of $230,000.00 has not been considered as a part of the cost basis.

In your return you reported the gross sales price as $379,514.46 whereas the amount should have been $609,514.46, or an understatement of $230,000.00.

COMPUTATION OF INCOME TAX

Year: 1947

Net income		$456,408.14
Less: Dividends received credit		19,125.00
Normal tax and surtax net income		$437,283.14
Alternative tax:		
Normal tax and surtax net income		$437,283.14
Less: Excess of net long-term capital gain over net short-term capital loss		393,602.03
Adjusted normal tax and surtax net income		$ 43,681.11

Normal tax:			
Tax at 15% on	$ 5,000.00	$ 750.00	
Tax at 17% on	15,000.00	2,550.00	
Tax at 19% on	5,000.00	950.00	
Tax at 31% on	18,681.11	5,791.14	
Normal tax on	$43,681.11	$10,041.14	$ 10,041.14
Surtax:			
Tax at 6% on	$25,000.00	$ 1,500.00	
Tax at 22% on	18,681.11	4,109.84	
Surtax on	$43,681.11	$ 5,609.84	5,609.84
Total normal tax and surtax			$ 15,650.98
Add: 25% of capital gain			98,400.51
Alternative tax			$114,051.49
Tax at ordinary rates:			
Normal tax at 24% on $437,283.14			$104,947.95
Surtax at 14% on $437,283.14			61,219.64
Income tax at ordinary rates			$166,167.59
Income tax liability (alternative tax)			$114,051.49
Income tax assessed:			
Original, Account No. 4101448			
First California District			47,968.95
Deficiency in income tax			$ 66,082.54

[Endorsed]: T.C.U.S. Filed August 18, 1952.

[Title of Tax Court and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above-named, by his attorney, Charles W. Davis, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed

by the above-named petitioner, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Denies that taxes for the year 1946 are in controversy in this proceeding; admits the remaining allegations contained in paragraph 3 of the petition.

4. (a) through (g). Denies the allegations of error contained in subparagraphs (a) through (g) of paragraph 4 of the petition.

5. (a) Denies the allegations of fact contained in subparagraph (a) of paragraph 5 of the petition.

(b) Admits that on December 21, 1946, petitioner was the owner of all the issued and outstanding stock of McDonald Ltd.; denies the remaining allegations of fact contained in subparagraph (b) of paragraph 5 of the petition.

(c) Denies the allegations of fact contained in subparagraph (c) of paragraph 5 of the petition.

(d) Admits that petitioner reported on its 1946 income tax return a dividend from McDonald Ltd.; for lack of sufficient information upon which to form a belief as to the correctness thereof, respondent denies the remaining allegations of fact contained in subparagraph (d) of paragraph 5 of the petition.

(e) Admits the first three sentences contained in subparagraph (e) of paragraph 5 of the petition;

denies the remaining allegations of fact contained therein.

(f) Denies the allegations of fact contained in subparagraph (f) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ CHARLES W. DAVIS,
Chief Counsel, Bureau of Internal Revenue

Of Counsel: B. H. Neblett, District Counsel; T. M. Mather, Charles W. Nyquist, Special Attorneys, Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed September 30, 1952.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It Is Hereby Stipulated and Agreed by and between the parties hereto, acting through their respective counsel, that the facts hereinafter set forth shall be taken as true for purposes of this proceeding; provided, however, that this stipulation shall be without prejudice to the rights of the parties hereto to introduce other and further evidence not inconsistent with the facts herein stipulated and to

object to the materiality or relevancy of any of the facts stipulated:

1. McDonald Island is located in the Delta Region of the San Joaquin River in San Joaquin County, California, approximately ten miles northwest of the City of Stockton. The island comprises and at all times involved in this controversy has comprised two tracts; a slough which forms a natural dividing line runs between the tracts. One tract contains approximately 2,700 acres and is known as the Henning Tract; the other contains approximately 3,400 acres and is known as the McDonald Tract. Substantially all of said island is farming land and has been farmed year after year. In 1935 presence of gas under the surface of said island was indicated and wells were brought into production in 1937.

2. Weyl-Zuckerman & Co., the petitioner, hereinafter called "Weyl", was organized in 1907 as a California corporation. The Henning tract was acquired by Weyl prior to 1932.

3. For many years prior to 1943 the McDonald Tract was owned by McDonald Island Farms, Ltd., a California corporation, hereinafter called "McDonald Ltd."

4. At the time of the incorporation of McDonald Ltd. and for some years thereafter until the year 1931 neither Weyl nor any of its shareholders had any interest in McDonald Ltd. In 1931 three members of the Zuckerman family purchased one-half of the outstanding shares of McDonald Ltd. and

Holly Sugar Corporation, hereinafter called "Holly", purchased the remaining one-half thereof. Later in 1934 the Zuckermans transferred their shares to Weyl in consideration for shares of Weyl.

5. As of August 11, 1943, McDonald Ltd. declared a dividend in kind to its stockholders, as a result of which Weyl and Holly each received a one-third (⅓) interest in the surface rights of the McDonald Tract, McDonald Ltd. retaining the remaining one-third (⅓) of the surface rights and all of the mineral rights. As of about the same date Holly gave Weyl an option to purchase Holly's said one-third (⅓) interest in said surface rights for $120,-280.30. Said option was transferred to Zuckerman Potato Co., a partnership, which exercised it and Holly conveyed to Zuckerman Potato Co. on December 27, 1944.

6. As of March 13, 1946, McDonald Island Farms declared a dividend in kind of the mineral rights in the McDonald Tract; Weyl and Holly each received a 50% interest in said mineral rights. At the same time Holly gave Weyl an option to purchase Holly's said 50% interest in the McDonald Tract mineral rights for $120,000. As of the same date Weyl purchased Holly's 50% of the capital stock of McDonald Ltd., and thereby became owner of all of McDonald Ltd.'s outstanding capital stock.

7. As of June 5, 1946, Weyl exercised its option to purchase Holly's 50% interest in the mineral rights in the McDonald Tract.

8. Attached hereto and marked Exhibits 1-A and 2-B are photostatic copies of the corporation in-

come tax returns of the petitioner for the taxable years 1946 and 1947.

/s/ DAVID LIVINGSTON,
Counsel for Petitioner
/s/ DANIEL A. TAYLOR,
Chief Counsel, Internal Revenue Service,
Counsel for Respondent

[Endorsed]: T.C.U.S. Filed March 17, 1954.

[Title of Tax Court and Cause.]

FINDINGS OF FACT AND OPINION

Filed February 14, 1955.

Petitioner owned a tract of land with valuable mineral rights. The mineral rights had a zero basis. Petitioner transferred the entire property to a wholly-owned subsidiary, and, after having arranged to sell a portion of these rights, petitioner reacquired the mineral rights from the subsidiary as a dividend in kind. It then consummated the sale. Held, in the circumstances of this case, that petitioner intended from the outset to reacquire the mineral rights from the subsidiary for purposes of sale, that the transfer of the mineral rights to the subsidiary was without business purpose and was lacking in bona fides, and that the reacquisition of the mineral rights by petitioner from the subsidiary did not result in a stepped-up basis.

David Livingston, Esq., and Louis F. DiResta, C.P.A., for the petitioner.

Charles W. Nyquist, Esq., for the respondent.

Respondent determined a deficiency in the income tax of petitioner for the year 1947 in the amount of $66,082.54.

The sole question is whether, in determining petitioner's basis for gain or loss of gas rights in a tract of land known as the Henning Tract, transactions involving a transfer of these rights by petitioner to a wholly owned subsidiary in June of 1946 and a reconveyance back to petitioner in December of 1946 should be disregarded as being without substance or business purpose.

Findings of Fact

Petitioner, a California corporation (hereinafter referred to as "Weyl"), was organized in 1907. Its principal office was located in Stockton, California. Its income tax return for the year 1947 was filed with the collector of internal revenue for the first district of California.

McDonald Island is located in the Delta Region of the San Joaquin River in San Joaquin County, California, approximately ten miles northwest of the city of Stockton. The island comprises and at all times involved in this controversy has comprised two tracts. A slough which forms a natural dividing line runs between the tracts. One tract contains approximately 2,700 acres and is known as the Henning Tract; the other contains approximately 3,400 acres and is known as the McDonald Tract. Sub-

stantially all of this island is farming land and has been farmed year after year. In 1935 presence of gas under the surface of the island was indicated and wells were brought into production in 1937.

The Henning Tract was acquired by Weyl in 1912 at a cost of $338,375. For many years prior to 1943 the McDonald Tract was owned by McDonald Island Farms, Ltd., a California corporation, hereinafter referred to as "McDonald Ltd."

Prior to the year 1931 neither Weyl nor any of its shareholders had any interest in McDonald Ltd. In 1931 three members of the Zuckerman family purchased one-half of the outstanding shares of McDonald Ltd. and Holly Sugar Corporation, hereinafter referred to as "Holly", purchased the remaining one-half interest. Later, in 1934, the Zuckermans transferred their shares to Weyl in consideration for shares of Weyl.

On November 18, 1935, Weyl leased the mineral rights in the Henning Tract to Standard Oil Company of California, and McDonald Ltd. similarly leased to Standard Oil Company of California the mineral rights in McDonald Tract.

Weyl and Holly disagreed both as to the farming activities on McDonald Tract and also as to fiscal matters. Upon the insistence of Holly a dividend in kind was declared on August 11, 1943 by McDonald Ltd. The subject of this dividend was a two-thirds interest in the surface rights of McDonald Tract. Holly received a one-third interest, and Weyl received a one-third interest. McDonald Ltd., retained the remaining one-third undivided inter-

est. McDonald Ltd. also continued to own the mineral rights in the McDonald Tract.

Weyl's consent to the dividend was given on condition that Holly give Weyl an option to purchase for $120,280.30 the one-third interest to be acquired by Holly as the result of the dividend. Holly executed an option agreement.

The option was transferred by Weyl to the Zuckerman Potato Company, a partnership. The members of this partnership were stockholders and employees of Weyl. It was formed in 1942 for the purpose of farming leased lands in Oregon. On December 27, 1944, the partnership exercised the option and received from Holly its one-third interest in the surface rights of the McDonald Tract.

Petitioner had been having disagreements with Standard Oil Company in connection with apportionment of royalties and drilling of offset wells, as more fully hereinafter set forth. There appeared to be two possible solutions: the purchase of the gas rights by Standard or the institution of litigation to resolve the differences. In November of 1945, Standard Oil Company made an offer to Maurice Zuckerman, president of Weyl, of $500,000 for gas rights underlying both the Henning and McDonald Tracts. This offer was regarded as too low; it was not accepted.

In January 1946, Holly urged that McDonald Ltd. declare a dividend in kind to its shareholders of the mineral rights in the McDonald Tract. The board of directors of McDonald Ltd. at a meeting on January 22, 1946, concluded that "a dividend in

kind at this time of the mineral rights * * * might not be for the best interests of the corporation and its shareholders", and adopted a resolution that the mineral rights "be retained by the corporation until such time in the future when this Board of Directors may deem it advantageous and for the best interests of the corporation and its shareholders that such dividend be declared." Holly renewed its request at a meeting of the directors on March 8, 1946. Weyl consented to the declaration of the dividend on the condition that Holly give it an option to buy its share of the dividend. On March 11, 1946, the Commissioner of Corporations of the State of California approved an application filed for permission to make the dividend. On March 13, 1946, McDonald Ltd. declared the dividend and Weyl and Holly each received a 50 per cent interest in the mineral rights on the McDonald Tract. At the same time Holly gave Weyl an option to purchase Holly's 50 per cent interest in the McDonald Tract mineral rights. On the same day Holly also sold to Weyl its 50 per cent of the capital stock of McDonald Ltd., and Weyl thereby became owner of all of the outstanding stock of McDonald Ltd.

On June 5, 1946, Weyl exercised the option to purchase Holly's one-half interest in the mineral rights in the McDonald Tract. Upon the exercise of this option Weyl became the owner of all the mineral rights in this tract and had a cost basis for them of $238,666.28.

At the regular meeting of the board of directors of Weyl on May 1, 1946, a resolution was adopted

authorizing its president or vice president to endorse a promissory note of McDonald Ltd. payable to the Bank of America in the amount of $720,000 and guarantee payment of this note.

A promissory note, dated May 20, 1946, was executed by McDonald Ltd. It provided for the payment of $720,000 in installments prior to May 20, 1956. McDonald Ltd. also executed a deed of trust, dated May 20, 1946, "on the property of the corporation commonly known as the Henning Tract and McDonald Tract located on McDonald Island * * *" to secure payment of the note. The deed, which was acknowledged on June 27, 1946, specifically excepted from its provisions "All minerals, mineral substances, mineral interests, ores, oil, gas, asphaltum and other hydrocarbons lying in or under the Henning and McDonald Tracts."

In a letter dated June 15, 1946 to the Bank of America National Trust and Savings Association, McDonald Ltd. applied for a loan of $720,000 "to be evidenced by a promissory note dated May 20, 1946". This letter stated when payments would be made; that payment of the note was to be secured by deed of trust, and that——

The undersigned hereby agrees that on or before the 1st day of April 1947, and annually thereafter, additional payments on account of principal of said loan will be made to said Bank in a sum equivalent to the difference between the minimum payment of Twenty-Eight Thousand Eight Hundred and 00/100 ($28,800.00) Dollars as provided for in said note

and 35% of the net profits of the corporation for the prior fiscal year; net profits as here used shall mean profits before depreciation, but after provision for Income Taxes.

The lower left-hand corner of the letter contains the notation in writing "Accepted Julius Blum, Vice Pres. Bank of America N.T.&S.A. Stockton, Calif."

On or about June 15, 1946, Weyl purchased from the partnership, Zuckerman Potato Co., its one-third interest in the surface rights of the McDonald Tract for which Weyl paid cash at the time. No deed was ever executed for this transfer. On June 27, 1946, Weyl sold a two-thirds interest in the surface rights in the McDonald Tract to McDonald Ltd., and it so entered the sale on its books. The conveyance with respect to one-third of the surface rights was made directly from the partnership to McDonald Ltd. by deed executed on June 27, 1946.

The Henning Tract had a cost to petitioner of $338,375, but its value had been written up on petitioner's books, so that in June of 1946 it was carried on these books at a value of $811,750. The mineral rights in this tract had no cost basis to petitioner. On June 27, 1946, Weyl conveyed to McDonald Ltd. the entire fee of the Henning Tract, including surface and mineral rights. This was entered on petitioner's books as a sale for $338,375 and a book loss of $473,375 was written off to surplus. The amounts entered on petitioner's books as sales price of Henning Tract ($338,375) and as sales price for two-thirds of the McDonald Tract surface rights ($226,-

843.22) were less than their fair market value on June 27, 1946.

In July of 1946, Maurice Zuckerman, the then president of Weyl, went to the offices of the Standard Oil Company and offered to sell the gas rights in both tracts for $875,000; on the same day he later indicated that he would be willing to reduce the figure to $820,000. Standard Oil rejected this offer in August of 1946.

Henning Tract and McDonald Tract were portions of a single gas field which also included two other properties in the vicinity one of which was owned by Mayberry and the other by Tilden. As gas was withdrawn from the field the Standard Oil Company determined the percentage to be allocated to each of the four properties and paid royalties on that basis. A dispute arose between Standard Oil and Weyl as to its allotment and also as to whether Standard Oil Company was obligated to drill an offset well on the McDonald Tract after it had drilled a well on the Mayberry property. Differences between petitioner and Standard had existed for several years. Standard's offer to purchase the gas rights for $500,000 in November of 1945 was an effort to solve the problem in that manner. At the time of Standard's rejection of the $820,000 offer in 1946, John Zuckerman informed Standard's representative that Weyl was making preparations to institute suit.

On December 12, 1946, John Zuckerman, then manager of Weyl and president and manager of

McDonald Ltd., conferred with the Standard Oil representative. He told the representative that they did not like to sue and would like to sell their interests in the gas rights. At that meeting a basis for determining a sales price for the mineral rights in both tracts was discussed.

On December 16, 1946, a price for the sale of gas rights underlying both the Henning and McDonald Tracts was agreed upon between representatives of Standard Oil Company and the petitioner, subject to ratification by their superiors. However, prior to the consummation of the sale, the board of directors of McDonald Ltd., on December 21, 1946, adopted a resolution declaring a dividend in kind of the mineral rights in the Henning Tract. By deed dated December 21, 1946 (recorded January 10, 1947) McDonald Ltd. conveyed these mineral rights to Weyl. It was of no importance to Standard whether title to the gas rights underlying the Henning Tract was conveyed directly by McDonald Ltd., or in some other manner, and Standard had prepared papers which were intended to consummate the sale. However, petitioner's counsel desired that the conveyance take a different route, and the route adopted—involving a transfer of mineral rights underlying the Henning Tract from McDonald Ltd. to Weyl, followed by a conveyance of gas rights underlying both tracts from Weyl to the buyer—was in accordance with the plan proposed by petitioner and the papers subsequently submitted by petitioner's counsel.

Standard elected to take title in the name of a

subsidiary, Pacific Oil Company, and, on January 20, 1947, a deed to Pacific Oil Company of gas rights in McDonald Tract and Henning Tract, reserving oil, asphaltum, minerals and hydrocarbons other than gas, and also reserving gas rights below a specified depth, was executed and acknowledged by Weyl.

On Weyl's 1946 Federal income tax return it reported the receipt of a dividend of the mineral rights underlying Henning Tract at a fair market value of $230,000, and claimed a dividend received credit.

The gross sales price of the gas rights which petitioner sold to Pacific Oil Company in January of 1947 was $609,514.46. Of this amount $230,000 was allocable to the Henning Tract gas rights, and $379,514.46 was allocable to the McDonald Tract gas rights.

In its income tax return for 1947, the petitioner claimed that its basis for gain or loss on the Henning Tract gas rights was $230,000, that the amount received therefor was $230,000, and reported no profit on their sale. The respondent disallowed all of the claimed basis of $230,000 and determined a deficiency of $66,082.54 in petitioner's income tax for 1947.

Opinion

Raum, Judge: McDonald Island consisted of two tracts of land, Henning Tract and McDonald Tract, both used for farming. In addition, gas had been discovered under the island in 1935, and

thereafter the gas rights were leased to Standard Oil Company of California. Petitioner had owned the Henning Tract for a long period of years. The mineral rights under that land had a zero basis to petitioner. On June 27, 1946, petitioner transferred the Henning Tract, including the mineral rights, to its wholly owned subsidiary at its original cost, which was substantially less than its then fair market value as well as less than its book value. In December, 1946, when a sale of the gas rights under the entire island to Standard Oil had already been arranged, the mineral rights, including gas rights, under the Henning Tract, were declared as a dividend by the subsidiary and reconveyed to the petitioner. The value of the gas rights at that time was $230,000. Shortly thereafter the sale was consummated, and the portion of the sale price allocable to the gas rights under the Henning Tract was $230,000. Although these gas rights had a zero basis in the hands of petitioner for a number of years, its contention is that by reason of the conveyance to the subsidiary and reconveyance some six months later as a dividend, these rights acquired a stepped-up basis equal to $230,000, with the result that it realized no gain upon the sale.

The Commissioner argues that the transfer of the mineral rights to the subsidiary was not bona fide, that no business purpose was served or intended by such transfer, that the possible sale to Standard Oil was contemplated from the beginning, and that the round-trip of these rights from parent to subsidiary and back to parent again was engineered for

the purpose of attempting to obtain a stepped-up basis.[1]

The question is largely one of fact, for, if it be true that the round-trip of the mineral rights was in fact a sham and lacking in bona fides, petitioner's basis for the rights, namely zero, will be unaffected, and its gain on sale must be measured from that basis.

In cases of this character the absence of any direct evidence of sham is not surprising. If petitioner intended from the beginning, through those who controlled its affairs, to transfer the entire Henning Tract to the subsidiary with the expectation of a re-transfer of the mineral rights, it is hardly likely that such intention would be admitted. The intention, if it did exist, would ordinarily have to be established by circumstantial evidence. And in this connection it is important at the outset to bear in mind the matter of burden of proof. Petitioner's counsel completely misconceives the burden of proof when he says in his reply brief "In order successfully to attack the conveyance of Henning Tract as

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[1] Of course, on petitioner's theory, the re-transfer of the rights to it by the subsidiary would result in petitioner receiving a taxable dividend in the amount of $230,000. However, by reason of Section 26(b), I.R.C. of 1939, 85 per cent of that dividend is received tax-free. In substance, therefore, the tax advantage to petitioner would be that it would be chargeable with dividend income in the amount of only 15 per cent of $230,000, while the entire gain of $230,000 upon sale of the gas rights to Standard Oil would be tax-free.

to mineral rights, the Commissioner must show that they were included with the intent to pull them back again into the petitioner for purposes of ultimate disposition." The burden is not upon the Commissioner. The burden is upon the petitioner to overcome the correctness of the Commissioner's determination. Moreover, the requisite business purpose or intention must be established by evidence; it is not enough for counsel to theorize as to what the intention might have been. It must be shown by satisfying evidence that the alleged business purpose was in fact entertained as a motivating factor by petitioner or its responsible representatives; a possible business purpose conceived after the event in order to give color to the transaction cannot retroactively supply the required bona fides which might otherwise be lacking. We have concluded, after hearing the witnesses and studying the entire record, that the alleged business purposes relied upon by petitioner to explain the manner in which the transaction was carried out were colorable only, and that the round-trip of the mineral rights was contemplated from the start and was lacking in bona fides.

Prior to the issuance of the deficiency notice in this case, petitioner filed a written protest against the proposed deficiency. The protest stated two reasons for the transfer of the mineral rights to petitioner's subsidiary, as follows:

* * * The transfer was made so that all the McDonald Island property would be owned by one company and thereby lend itself to a more efficient

conduct of farming operations. Also, all the land could then be pledged as collateral to a trust deed note with a bank. * * *

Each of these reasons is spurious. While it may be true that the farming operations on McDonald Island could be more efficiently conducted if all the surface rights were in a single ownership, the ownership of the mineral rights is completely immaterial in this connection. Indeed, when petitioner on June 27, 1946, transferred to its subsidiary the Henning Tract and its interest in the surface rights in the McDonald Tract, it at the same time retained and did not transfer to the subsidiary the mineral rights in the McDonald Tract. Moreover, the December 21, 1946, resolution of the board of directors of the subsidiary, providing for the re-transfer of the mineral rights to petitioner explicitly recited that "none of the rights * * * are necessary for the operation of the business of this corporation and may be distributed to the stockholder thereof by way of a dividend in kind." It is quite plain that they were no more necessary to the business of the subsidiary on June 27, 1946, when they were first transferred by petitioner as part of the entire Henning Tract.

The second reason suggested by the protest, i.e., that the land could be pledged as collateral to secure a bank loan, is equally spurious. The evidence shows that the loan in question had already been negotiated, and that it was to be secured by a deed of trust with respect to the entire island, excluding,

however, all mineral rights. It was therefore misleading to suggest that the proposed bank loan was a motivating factor in the transfer of the mineral rights to the subsidiary.

In the testimony before us, the reasons set forth in the protest were repeated and embellished. However, we are firmly convinced on this record that these reasons did not in fact play any part whatever in the transfer of the mineral rights. And other reasons advanced, some of them merely variations of the foregoing, appear to us to be afterthoughts. We are satisfied that the transfer of the mineral rights had in fact no business purpose whatever, other than to set the stage for an attempt to establish a stepped-up basis for these rights.

It should be remembered that petitioner was encountering difficulty with Standard Oil in connection with Standard's leases of these gas rights. One way of settling the dispute was to have Standard purchase the rights. Standard had made an offer of $500,000 for the gas rights under the entire island in November 1945. The offer was considered too low and was not accepted. The conflict between Standard and the petitioner persisted. The transfer of the Henning Tract to the subsidiary took place on June 27, 1946, and shortly thereafter, in July 1946, petitioner's president offered to sell the gas rights under the entire island to Standard for some $800,000. Here then was a situation where petitioner knew that a sale to Standard was a distinct possibility, provided that a satisfactory price

could be agreed upon, and where its president[2] reactivated the negotiations with Standard after transferring the rights to the subsidiary. To be sure, the evidence is circumstantial, but it is strong and convincing that when petitioner transferred the Henning Tract to the subsidiary it intended to recapture the mineral rights. True, it was not able to come to terms with Standard in July or August of 1946, but negotiations were opened again in December of the same year, and an agreement was finally reached at that time.

It is no answer to say, as does petitioner's counsel, that petitioner merely employed a standard form of deed on June 27, 1946, when it transferred Henning Tract in its entirety to the subsidiary. Petitioner at that time was fully aware of a separate interest in the mineral rights, for, on the same day, its deed of its interest in the McDonald Tract to

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[2] The protest falsely stated that after the transfer, "the petitioner was approached by a third party desiring to purchase all the known mineral rights located on the McDonald Island," identifying the third party as Pacific Oil Company. The fact is, as plainly shown by the evidence, that it was petitioner's president who approached Standard. The initiative at this time did not come from Standard or its subsidiary, Pacific Oil Company. This is a difference of great importance in the context of this case, for it shows that petitioner sought to bring about a sale of the mineral rights shortly after transferring them to the subsidiary. The affirmative step thus taken by petitioner within so short a period is highly persuasive that the transfer was made with a view towards attempting to bring about a sale thereafter.

the same subsidiary expressly excluded the mineral rights. And later, on the same day, the deed of trust to secure the bank loan expressly excluded the mineral rights under the very tract here involved. We are satisfied on the evidence that the course of action taken by petitioner was deliberate and calculated, without business purpose other than to establish an artificially stepped-up basis. The gas rights in the Henning Tract had a zero basis in petitioner's hands, and we hold that the planned excursion of these rights from petitioner to its subsidiary and back again to petitioner could not result in any stepped-up basis. The intermediate steps were lacking in bona fides, and must be ignored.

Decision will be entered for the respondent.

The Tax Court of the United States
Washington

Docket No. 43504

WEYL-ZUCKERMAN & COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed February 14, 1955, it is ordered and decided: That

there is a deficiency in income tax of $66,082.54 for the year 1947.

Entered: Feb. 15, 1955.

[Seal] /s/ ARNOLD RAUM,
Judge

[Title of Tax Court and Cause.]

PETITION FOR REVIEW

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

1. Weyl-Zuckerman & Company, a corporation, represents that on February 15, 1955, the Tax Court of the United States rendered a decision that there is a deficiency in income tax of petitioner in the sum of $66,082.54 for the year 1947.

2. Petitioner represents that it is a California corporation and that its return for Federal tax purposes for the taxable year 1947 was made to the Collector of Internal Revenue for the First District of California, which is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit.

3. The nature of the controversy is as follows: What was the cost base to petitioner of the mineral rights underlying a tract of farming land—known as Henning Tract—which were sold in January 1947 by petitioner to Pacific Oil Company.

The determination of the foregoing issue depends in turn on the question whether the conveyance by petitioner in June 1946 to its subsidiary of the entire fee of the property, including surface and mineral rights, was for a business purpose.

When—approximately seven months later—an opportunity for sale of the mineral rights arose, the subsidiary declared a dividend in kind of the rights. Accordingly, they were conveyed by the subsidiary to the petitioner and the sale was consummated.

The Tax Court has decided that the conveyance in June 1946 by petitioner to its subsidiary was a subterfuge; that at the time of the conveyance the petitioner intended to have the mineral rights returned to it as a dividend, and that petitioner's purpose from the beginning was to set up the cost basis of the rights and by that means reduce the capital gain on the subsequent sale to Pacific Oil Company.

Petitioner contends that there is no evidence to support the conclusion of the Tax Court; that there are no findings of fact that justify the decision; that there is no evidence that at the time of the conveyance of the Henning Tract to the subsidiary a sale to Pacific Oil Company, or any other person, was in contemplation or deemed likely; that there is no evidence that the prospect of a sale played any part in the reasons which actuated the conveyance to the subsidiary; that such conveyance was made for adequate and genuine business reasons; that the idea of a dividend of the mineral rights by the subsidiary to petitioner first arose when an opportunity

to sell the rights presented itself in December 1946; and that the expedient of a dividend was adopted in order to avoid the payment of a substantial sum on account of an existing indebtedness if the conveyance to the Pacific Oil Company had been made directly by the subsidiary.

4. As the basis for review, petitioner submits the following assignments of error:

(a) The Tax Court erred in holding that the sale of Henning Tract by petitioner to its subsidiary was sham and not bona fide.

(b) The Tax Court erred in holding that the conveyance to the subsidiary of Henning Tract in its entirety, and the dividend of mineral rights from the subsidiary which occurred seven months later, was contemplated from the beginning as a means of reducing the capital gain on the prospective sale of the rights to Pacific Oil Company.

(c) The Tax Court erred in holding that there was no evidence of a business purpose in the transfer of Henning Tract by petitioner to its subsidiary.

(d) The Tax Court erred in holding that there was merely a possible business purpose in the conveyance conceived after the event in order to give color to the transaction.

(e) The Tax Court erred in holding that there is circumstantial evidence that when petitioner transferred the Henning Tract to the subsidiary it intended to recapture the mineral rights.

(f) The Tax Court erred in holding that the course of action taken by petitioner was deliberate and calculated, without business purpose, other than to establish an artificially stepped-up basis.

(g) The Tax Court erred in ordering and decreeing that there is a deficiency in income tax against petitioner of $66,082.54 for the year 1947.

Wherefore, your petitioner prays that the Court of Appeals review said decision of the Tax Court pursuant to applicable statutes and rules of said Court of Appeals.

Dated: May 9, 1955.

/s/ DAVID LIVINGSTON,
Attorney for Petitioner

Duly Verified.

[Endorsed]: T.C.U.S. Filed May 11, 1955.

[Title of Tax Court and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To the Chief Counsel, Internal Revenue Service, Washington, D. C., Attorney for Respondent:

You Are Hereby Notified that on May 11, 1955, petitioner filed with the Clerk of the Tax Court of the United States at Washington, D. C., a petition for review by the United States Court of Appeals for the Ninth Circuit of the decision of said Tax Court

rendered on February 15, 1955, in the above entitled case. Attached hereto is a copy of said Petition for Review.

Dated: May 11, 1955.

/s/ DAVID LIVINGSTON,
Attorney for Petitioner

Affidavit of Service by Mail attached.

[Endorsed]: T.C.U.S. Filed May 13, 1955.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of the United States, do hereby certify that the following documents, 1 to 13, inclusive, constitute and are all of the original papers and proceedings, including joint exhibits 1-A and 2-B attached to the Stipulation of Facts, Petitioner's exhibits 3 through 10 admitted in evidence, Respondent's exhibits C through G and J admitted in evidence, (H, I and K-M.F.I. and not left with the record) on file in my office as called for by the "Designation of Contents of Record on Review" and "Designation for Additional Portions of Record on Review" in the proceeding before The Tax Court of the United States entitled: "Weyl-Zuckerman & Company, Petitioner, vs. Commissioner of Internal Revenue, Respondent, Docket No. 43504", and in which the petitioner in The Tax Court proceeding has initiated an appeal

as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 25th day of May, 1955.

[Seal] /s/ VICTOR S. MERSCH,
Clerk, The Tax Court of the
United States

The Tax Court of the United States

Docket No. 43504

WEYL-ZUCKERMAN & COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

TRANSCRIPT OF PROCEEDINGS

Room 421, Appraisers Building, 630 Sansome St., San Francisco, Calif., Thursday, March 18, 1954—10:15 a.m.

(Met, pursuant to adjournment.)

Before Honorable Arnold Raum, Judge.

Appearances: David Livingston and Louis F. Di Resta, Russ Bldg., San Francisco, Calif., appear-

ing for Petitioner. Charles W. Nyquist (Honorable Daniel A. Taylor, Chief Counsel, Bureau of Internal Revenue, appearing on behalf of Respondent. [1*]

* * * * *

[Clerk's Memo: Official report of proceedings before the Tax Court on March 17 and 18, 1954, consisting of 203 pages, beginning with the testimony of John Zuckerman at page 22, and excluding the opening statements which precede the testimony.]

Whereupon,

JOHN ZUCKERMAN

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Have a seat, sir, and state your name and address, please.

The Witness: My name is John Zuckerman, address is 2308 Virginia Lane, Stockton, California.

Q. (By Mr. Livingston): Were you a director of Weyl-Zuckerman and Company in the years 1946 to—in the years 1941 to 1946?

A. No, sir.

Q. What connection did you have with Weyl-Zuckerman during that period?

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* Page numbers appearing at top of page of original Reporter's Transcript of Record.

(Testimony of John Zuckerman.)

A. I was farming superintendent and manager.

Q. And did you have any official capacity with the [22] McDonald Island Farms, Ltd.?

A. Yes, sir, I was director and president.

Q. Are you familiar with the transaction which occurred on March 13, 1946, involving the purchase by Weyl-Zuckerman and Company, a corporation, from Holly Sugar Company, a corporation, of one-half of the outstanding capital stock of McDonald Island Farms, Ltd.? A. Yes.

Q. Do you know the price of that stock was $216,620, was it not? A. Yes.

Q. Do you know the source from which the money was obtained in order to pay that purchase price?

A. Yes, it was borrowed from the Bank of America.

Q. Was there any negotiation at that time for the—for obtaining a larger loan from the Bank of America or did those negotiations——

A. What was the date, Mr. Livingston?

Q. March 13, 1946. A. No.

Q. When did the negotiations initiate?

A. Sometime after that.

Q. Can you tell me anything more definite as to the point of the time?

A. Almost immediately after the Holly stock was acquired, [23] then I began negotiating with the Bank of America and also with the Prudential Life Insurance Company.

Q. Well, let's eliminate the first, the Prudential

(Testimony of John Zuckerman.)

Life Insurance Company. What happened in respect to those negotiations, were they terminated without result or what? A. Yes.

Q. All right. Now as to the Bank of America, were those negotiations successful?

A. Yes, we borrowed *$72,000.*

Q. And in order to borrow that *$72,000* what was necessary to provide security?

A. Well, we had to give——

Mr. Nyquist: Objection, your Honor, to what is necessary; calling for a conclusion of a witness. He may not know what was necessary.

Mr. Livingston: Well, may I put it this way, then:

Q. (By Mr. Livingston): What did the Bank of America require as security?

A. They required a deed of trust on the entire 6100 acres contained in McDonald Island.

Q. Pardon me just a moment. Let me interrupt. When you say 6100 acres, that refers to both sides of McDonald Island?

A. Yes, sir, the entire.

Q. One side being called McDonald Tract? [24]

A. That had 3400 acres.

Q. And the other side is called Henning Tract?

A. Yes, sir, that has 2700 acres.

Q. Now, you got as far as telling us they required a deed of trust on that property.

A. They required a deed of trust on the property. *The* required notes, naturally, and they required that we discharge certain obligations, certain

(Testimony of John Zuckerman.)

liens against the various parts of the island. They wanted one ownership and they wanted an agreement that should we make, in any one year——

Mr. Nyquist: Objection, your Honor. If we are going to testify about the term of an agreement I should think the agreement itself is the best evidence.

Mr. Livingston: I agree with counsel. We have a photostatic copy of the agreement itself. We will get that later on.

Q. (By Mr. Livingston): Anyhow, they wanted some agreement with respect to cash payments, is that it? A. Yes, sir.

Mr. Livingston: I am showing counsel now a deed of trust dated May 20th, 1946, McDonald Island Farms, Ltd.

Mr. Nyquist: Do you want me to take time to read it? [25]

Mr. Livingston: Oh, no, I wouldn't suggest that you do that, just at your convenience. After counsel has had an opportunity to examine that I will make my offer.

Q. (By Mr. Livingston): Now, can you tell me in whose name this property was placed at that time?

A. McDonald Island Farms, Ltd.

Q. And——

The Court: By "this property" you mean what?

Mr. Livingston: The——

The Court: What does the witness mean?

(Testimony of John Zuckerman.)

Q. (By Mr. Livingston): Yes, what do you mean by the "property"?

A. The entire island, McDonald Island, the 6100 acres of land.

The Court: That is both surface and subsurface rights?

The Witness: No, your Honor.

Mr. Livingston: No.

The Court: You shouldn't use such loose terms as "this property"; I don't know what you mean by that.

Mr. Livingston: I intend to define it more accurately.

Q. (By Mr. Livingston): In whose name were the surface rights placed in [26] respect to McDonald Island or the McDonald Tract?

A. May I ask at what time?

Q. For the purpose of this transaction.

A. McDonald Island Farms, Ltd.?

Q. Yes, and from whom were the surface rights acquired, if any surface rights were so acquired at that time?

A. They were acquired from Weyl-Zuckerman and Company.

Q. What portion of the surface rights were owned by Weyl-Zuckerman and Company at that time?

A. 2700 acres, which was the Henning Tract.

Q. No, no. I mean, we are talking now, I think I have confused you—we are talking now about the surface rights of McDonald Tract. I think you have

(Testimony of John Zuckerman.)

testimony thus far that the surface rights of McDonald Tract were embodied in a deed of trust to the Bank of America together with other property.

A. That is right.

Q. Now, confining yourself to the surface rights on McDonald Tract, I am asking you what portion of those rights at that time and prior to this transaction of June 27th, 1946, were owned by Weyl-Zuckerman and Company?

A. One-third was owned by Weyl-Zuckerman and Company.

Q. Now, what if any, interest in the surface rights did Zuckerman Potato Company, the partnership, have in those? A. One-third.

Q. And the other one-third still remained in the name [27] of McDonald Island Farms, Ltd.?

A. Yes, sir.

Q. That accounts for the three thirds, or the entire surface rights on McDonald Tract, is that correct? A. Correct.

Q. And I believe you testified—strike that, please.

Did Weyl-Zuckerman and Company, prior to this deed of trust, transfer its one-third of the surface rights to McDonald Farms, Ltd.?

A. Yes, sir.

Q. Did Zuckerman Potato Company, a partnership, make a similar transfer? A. Yes, sir.

Q. All right. Now, with reference to the other side of the island, that was called Henning Tract, is—— A. Yes.

(Testimony of John Zuckerman.)

Q. ——that correct? A. Yes, sir.

Q. And prior to this transaction with the Bank of America, who was the owner of Henning Tract?

A. Weyl-Zuckerman and Company.

Q. And in order—did Weyl-Zuckerman and Company deed the property known as Henning Tract to McDonald Island Farms, Ltd., so that McDonald Island Farms, Ltd., could, in turn, hypothecate that property to the Bank of America?

A. Yes, sir.

Q. Now, the transaction involving the transfer of Henning Tract by Weyl-Zuckerman and Company to McDonald Island Farms, Ltd., was there any differentiation to surface rights and to mineral rights? A. No, sir.

Mr. Nyquist: May I have that question again? I didn't quite get it.

(The last question was read by the reporter.)

Mr. Nyquist: Your Honor, I object to that question as being vague and indefinite and unintelligible and I ask that the question and answer be stricken.

Mr. Livingston: I will be glad to improve on it, if it is necessary.

Mr. Nyquist: I don't know what it means.

Mr. Livingston: Well, the question means: did they transfer the property in its entirety——

The Court: Suppose you rephrase the question.

Q. (By Mr. Livingston): When the transfer of Henning Tract was made to McDonald Farms, Ltd., from Weyl-Zuckerman and Company, was the prop-

(Testimony of John Zuckerman.)

erty transferred in its entirety or were mineral rights divorced from the surface rights?

A. It was transferred in its entirety.

Q. Now, can you state whether or not there were business [29] reasons for consolidating the two portions of the island into one portion?

Mr. Nyquist: Objection, your Honor. That calls for a conclusion of the witness and it is what this court is called upon to decide. If he has any reasons he wants to state that may be another matter, but as to what constitutes business reasons I think is the ultimate conclusion.

Mr. Livingston: I will ask him then:

Q. (By Mr. Livingston): Assuming that objection to be sound, will you state what, if any, business reasons there were for that transaction?

Mr. Nyquist: I would like to further ask that question be clarified as to whose reasons is he talking about, this witness's reasons, one corporation's reasons, another corporation's reasons, or whose reasons are we talking about here?

Mr. Livingston: Well, I assume it is the reasons that actuated the witness and his associates in connection with these transactions.

The Court: You may ask him why it was done in the manner in which the transaction was handled.

Mr. Livingston: I will adopt that question, if I may, your Honor.

Q. (By Mr. Livingston): Why was this transaction, involving the transfer of [30] the property that you have described to McDonald Island Farms,

(Testimony of John Zuckerman.)

Ltd. handled in the manner in which it was handled?

A. Well, the reason that the property was all put in the name of McDonald Island Farms, there were two general classes of reasons, one was farming reasons, the other was financial reasons, that is, relating to the financing of the purchase. The farming reasons were that here were two large pieces of land being farmed side by side, they were both suitable for similar crops and it was far more economical to operate them as one unit than as two separate units. The reasons for this are, under mechanized farming, you have to own a lot of mechanized equipment, men operating two sets of equipment, operating two separate machine shops which are very expensive with probably ten or fifteen mechanics in each, meant keeping two complete sets of books, two sets of employees, it meant that any time one piece of equipment or more, or employees from one side of this island crossed Wiskey Slough, which is the dividing line and worked on the other side, it all had to be accounted for, charge made to the other corporation, and in general, the bookkeeping process, the whole accounting process, the whole farming process, was far more costly under two ownerships than under one ownership.

The Court: Was that the fact prior to the transfer of all the property to McDonald, Ltd.?

The Witness: Yes, sir. [31]

The Court: You are not describing the hypo-

(Testimony of John Zuckerman.)

thetical situation, you are describing the facts as they existed?

The Witness: That is correct.

Mr. Livingston: Maybe I would like to clarify the record, your Honor. Maybe we are thinking the same thing, your Honor. As I understand it, the witness is describing the conditions that prevailed when two different owners are operating each of the two different sides of the island and the handicaps that are involved in that respect which could be overcome by single ownership; is that the impression that your Honor has?

The Court: The record will speak for itself.

Mr. Livingston: All right, then, let me clarify it.

The Court: You are not entitled to clarify anything yourself. You can adduce clarification from the witness.

Mr. Livingston: My expression was ill-advised. Let me make an effort to have the witness clarify it.

Q. (By Mr. Livingston): The conditions that you have described, were they the conditions that prevailed at the time when the ownership of the McDonald side, as opposed to the Henning side, were in different persons?

The Court: Well, he told me he was describing an actual situation and not a hypothetical one.

Q. (By Mr. Livingston): All right, now, what about the matter of planting crops?

A. That was what I was coming to. Our main crops, our principal crops, and the crops that return us the best revenue are potatoes. We like to

(Testimony of John Zuckerman.)

plant potatoes on the ground best suited for potatoes. We like to plant soil building crops on ground we like to rest. If we preserve these as two separate entities we would have to have some proportion of potatoes on each side of the island, some proportion of soil building crops on each side of the island, whereas if we had them on one ownership, one operation, if the land on one side of the island were best suited to potatoes we could use that without regard to having to have some on each side. This was always also true of other crops. Now, you want——

Q. Now, I think, will you go to the financial—you mentioned the financial aspect, the advantage of single ownership?

A. Yes. In order to properly secure a loan in the amount of $720,000, which we needed to consummate these various purchases——

The Court: What was it that you were purchasing?

The Witness: Well, we were purchasing the 2700 acres of the Henning Tract side from Weyl-Zuckerman and Company in the amount of three hundred and thirty—roughly 330,000. We were purchasing one-third of the surface rights. [33]

The Court: By "we" you are speaking of McDonald, Ltd.?

The Witness: Yes, sir, of which—yes.

The Court: Go on.

The Witness: All right. We were purchasing one-third of the McDonald Tract from the Zuckerman

(Testimony of John Zuckerman.)

Potato Company, we were purchasing one-third of the McDonald Tract from Weyl-Zuckerman and Company. May I go ahead? We were also obligated to pay off various liens and obligations against the land and in order to repay the bank the $216,000 which had been borrowed from them to buy the McDonald stock from Holly Sugar Company that money also had to be raised and the aggregate amount that was necessary to carry through this entire action was very close to $720,000.

Q. (By Mr. Livingston): Well, in answer to the Court's question I don't believe you mentioned the money that was necessary in order to buy the mineral rights under McDonald Tract from Holly Sugar Corporation.

A. That is correct. That is an additional $120,000.

The Court: Well, there has been testimony about a Zuckerman Potato Company. I haven't the remotest idea of what the Zuckerman Potato Company is, who they were, how they acquired any interest in the pertinent properties.

You have got this record in a confused state. [34]

Mr. Livingston: All I can say, your Honor, is I can't prove it all at once. I realize that thus far the record does not disclose——

The Court: Well, if you intend to bring all these matters out in due course——

Mr. Livingston: I hope so. If I miss some of them your Honor will certainly bring it to my attention.

(Testimony of John Zuckerman.)

The Court: Proceed.

Mr. Livingston: As long as we are on that subject now, let's go to it.

Q. (By Mr. Livingston): Who was the Zuckerman Potato Company?

A. Zuckerman Potato Company was a partnership made up of some of the principals and some of the employees of Weyl-Zuckerman and Company, and my best recollection is that it was formed in 1940—beg your pardon, '42. It was formed for the purpose of farming leased lands in Stockton, in Oregon, and in Kern County, for the purpose of responding to the Government's request that we produce this food production for the war effort.

Q. And then will you state why a separate partnership was formed for the purpose of expanding the farming activity rather than have Weyl-Zuckerman and Company, which was the existing corporation, do it?

A. There were two main reasons. One is we wanted to [35] bring some of our employees into a position where they were participating in the profits of our farming operations which was very difficult to do under our corporate structure. The other and the more—the main reason, was that these farming activities embraced about three or four thousand acres which required a capital outlay of at least a million dollars, sometimes more, and a very hazardous and a—and a hazardous type of venture where one frost or one market upset could wipe the whole thing out. Under the tax structure

(Testimony of John Zuckerman.)

that Weyl-Zuckerman and Company had everything they made over a very small amount would be subject to excess profits tax and we stood no chance of profiting, and we stood a tremendous chance of losing everything that we had, and being completely wiped out. Therefore, when we decided to expand or, in response to the request, to expand, we did it in the form of this partnership rather than as Weyl-Zuckerman and Company.

The Court: Well, how did part of this island get into the hands of the partnership?

The Witness: All right, sir——

Mr. Nyquist: That will be covered in the stipulation, your Honor.

The Court: Thank you very much.

Mr. Livingston: I would like, however, to explain it, if your Honor please. The Court has inquired on the subject of how that happened. Now, the stipulation will provide us [36] with the date upon which that occurred, but I think the stipulation will also disclose that Weyl-Zuckerman and Company, a corporation, was given an option by the Holly Sugar Corporation to purchase from Holly Sugar Corporation its one-third underwrited factional interest in the surface rights of McDonald Tract.

The Court: You understand that everything that you are saying is not evidence at all?

Mr. Livingston: I realize that.

The Court: I couldn't possibly make any finding of fact on the basis of anything you are saying. If these matters are in the stipulation of fact, I

(Testimony of John Zuckerman.)

can, of course, make a finding on it to the extent that you get testimony from this witness, I can make finding, but any statements that you make can not possibly be of any help other than merely to expand your opening statement of what you expect to prove.

Mr. Livingston: Well, I probably omitted something. Will you read the beginning of my statement, please? I thought I referred it to the stipulation of facts. If I didn't, I would like to amend it.

(Statement of counsel read by reporter.)

Q. (By Mr. Livingston): All right, now, the fact was, was it not, Mr. Zuckerman, that the option from the Holly Sugar Corporation to purchase the one-third interest in the surface rights of [37] McDonald Island Tract was conferred on Weyl-Zuckerman and Company? A. Yes, sir.

Q. Will you explain, please, why it was that the option, when exercised, was not exercised by Weyl-Zuckerman and Company but was exercised by this Zuckerman Potato partnership?

A. Yes. I—Zuckerman Potato Company, at that time, had the money to buy it with, to exercise the option, to pay Holly, and at that time Weyl-Zuckerman was hard up and didn't have the money. Therefore, that exercise was transferred to the Zuckerman Potato Company.

Q. You mean that option was transferred?

A. Option, I beg your pardon.

Q. To the partnership, and the partnership exercised—— A. Yes.

(Testimony of John Zuckerman.)

Mr. Livingston: And, I think we have explained, if your Honor please, how the Zuckerman Potato Company acquired that one-third interest.

Q. (By Mr. Livingston): All right. Will you kindly proceed and explain—proceed with your explanation of the reasons which existed at that time for consolidating the ownership of the surface rights on McDonald and the ownership of Henning Tract into McDonald Island Farms, Ltd.? I think you had covered all of [38] the farming aspects of it in your testimony and I would like to ask you what, if any, connection the McDonald history, financial history, had with the desirability of selecting McDonald as the owner?

Mr. Nyquist: Your Honor, I would like to ask that this be clarified at this time. This witness is obviously going to be asked a lot of questions about reasons. He was an officer of McDonald Island Farms, he was not an officer of Weyl-Zuckerman and Company, Petitioner. Now, are we talking about his personal reasons, or whose reasons are we talking about? I think the question should be clarified in this respect. In certain respects it might be subject to objection and in this vague form it is hard to tell how objectionable the questions are.

Mr. Livingston: I think the purpose of the question is to elicit facts from the witness. He has stated nothing but facts up to this moment in his explanation, and if necessary, I can ask whether any facts in the history of McDonald Island Farms, Ltd., which were related to or had connection with this

(Testimony of John Zuckerman.)

transaction and the vesting of title of the property heretofore described in McDonald Island Farms, Ltd.

Mr. Nyquist: Your Honor, a corporation, and we are dealing with corporations here, is an inanimate object which has no mind or reasons. Reasons are in people's minds. When [39] we are talking about reasons here, I would like to know whose reasons. The witness is testifying to his personal reasons or the reasons in somebody else's mind?

Mr. Livingston: He is about to testify to the facts. That is what I understand. That is the purpose of the question, what facts were there, and I will ask, Mr. Zuckerman, in giving your testimony to confine yourself to facts of which you have personal knowledge, your connection with these companies. The witness has testified that he was a director and president of McDonald Island Farms, Ltd., that he was the manager of Weyl-Zuckerman and Company, so I think he is qualified from his connection with those two companies to—at least he is able to provide the court with some indication that the facts concerning which he testifies are those which he knows, and facts, after all, are the things which——

The Court: That is not the basis for the Government's objection to your question. The Government is objecting to your question on the ground it is so vague it doesn't know whether it can be objected to or not.

(Testimony of John Zuckerman.)

Mr. Nyquist: Will you refine your question and make it more specific?

Mr. Livingston: I will do so. I am afraid I will meet with another objection; however, we will cross that bridge when we meet it. [40]

Q. (By Mr. Livingston): What was the condition of McDonald Island Farms, Ltd., with respect to excess profits credit?

A. May I answer? McDonald Island Farms, Ltd. had built up an excess profits credit, or an excess profits base, of somewhat in excess of a hundred thousand dollars and—Well, that answers the question.

Mr. Nyquist: May that be clarified as to time, please?

Mr. Livingston: Go ahead; Mr. Nyquist would like you to clarify that as to time.

Mr. Nyquist: When? When are you speaking about?

The Witness: 1946.

The Court: What do you mean it had built up in 1946? Are you speaking about a carry over from prior years?

The Witness: I am talking about it had an excess profits base of somewhere in excess of a hundred thousand dollars.

The Court: And that base was more than the company needed to absorb its current income?

The Witness: No, sir, I just said they had the base.

(Testimony of John Zuckerman.)

The Court: All right. It is not a very meaningful statement to me yet.

The Witness: Well, may I say why it is relevant? We wanted to keep this McDonald Island Farms corporation in [41] existence for several reasons: it had an excess profits tax base which we didn't want to lose; it had a potato acreage allotment which we didn't want to lose; it had a wheat allotment base; it had a history in a great many fields that would have been lost had that corporation gone out of farming existence. The reason we transferred all that property to McDonald Island Farms, Ltd. rather than some other corporation was to preserve all those things that McDonald Island Farms, Ltd., owned by virtue of its existence.

Q. (By Mr. Livingston): But, Mr. Zuckerman, the Court doesn't apparently understand why these factors were of a value, unless I misunderstood.

A. They were profitable to the owners and to the stockholders of the corporation.

Q. Why were there any reasons for that? For example, take this allotment, acreage allotment, what was the value of that to a corporation insofar as its future operations were concerned?

A. Well, at the time there was the price support program in existence whereby the Federal Government was supporting the price of potatoes. In order to meet with that price support program you had to keep your acreage within an allotment given by the Government to you. In order to have an allot-

(Testimony of John Zuckerman.)

ment you had to have a history, and McDonald Island [42] Farms, Ltd. had a history.

Q. All right. Now, what about the credit standing of McDonald Island Farms, Ltd., what facts existed in that respect?

A. It had a very good reputation. During the time that there was a joint ownership of Holly Sugar Company and Weyl-Zuckerman and Company and McDonald Island Farms, Ltd., their bills were always paid promptly, their discounts were taken at the time when that corporation was jointly entered into in 1931 by the two companies there had been an outstanding bond issue of some 340,000, those bonds had all been called in and paid off—most of them, that is, had been called in and paid off at par plus and in financial circles, McDonald Island Farms, Ltd. had a very fine credit rating which was not true of Weyl-Zuckerman and Company. They had been in financial difficulties from time to time.

Q. Now, what about the condition with respect to the mineral rights on the two portions of the island? What were the facts in that regard and what part did they play in maintaining or preserving two independent owners of the separate portions of the island?

A. There were certain provisions in our—I say "our" meaning both McDonald Island Farms, Ltd. and Weyl-Zuckerman and Company—leases with the Standard Oil Company calling for offset practices and—— [43]

(Testimony of John Zuckerman.)

Q. You mean by that the drilling of offset wells?

A. The drilling of offset wells under certain circumstances which are common to almost all mineral leases and it was our feeling that we would weaken that position, our position to ask for offsets if there was only one corporation their holding one thing, and if we extended our position as regards the Standard Oil Company by having these leases in the hands of the certain corporations.

Q. What about the ownership of equipment at that time, which of the two corporations owned the bulk of the equipment?

A. McDonald Island Farms, Ltd.

Q. And——

The Court: You are speaking of farming equipment now?

Mr. Livingston: Yes, sir.

The Witness: Yes.

Mr. Livingston: Farming equipment.

The Witness: There was a——

Q. (By Mr. Livingston): At that time, will you state what farming—in what farming operations Weyl-Zuckerman and Company was engaged outside of the State of California?

A. Yes, we were farming—Weyl-Zuckerman and Company was farming in Klamath County in Oregon, they were also farming and had been farming since 1944 in Iron County, Utah, [44] and a large 4,000-acre ranch we were developing, we were spending a considerable amount of money in development of this.

(Testimony of John Zuckerman.)

The Court: When you say "we" were you an officer of Weyl-Zuckerman and Company at the time?

The Witness: It is rather difficult for me to differentiate at this time because I was managing both companies, that is why I say "we".

The Court: I see.

Q. (By Mr. Livingston): What was the nature of this venture in Utah, was it a proved venture or was it still experimental?

A. Well, it was a highly speculative venture. We went into the desert in the Escalante Valley, we cleared a lot of sage, cleared wells where no one had cleared before, and we were in a highly speculative venture there and spending a lot of money.

Q. What connection did that have in the desirability keeping from out of state activities divorced from the in state activities?

A. Well, two instances. One is we didn't want to confuse the bookkeeping between the two. We wanted to keep the farming separate. The other was that we didn't want our—the McDonald Island property in Stockton to be jeopardized by possible losses that might take place in Utah and Oregon.

Q. Now, during—let's go back a little if you don't mind.

During the period while Holly Sugar Corporation owned a one-half, one-half of the outstanding shares of McDonald Island Farms, Ltd., were the farming operations on McDonald Island side, the McDonald Tract side, carried on independently of

(Testimony of John Zuckerman.)

the farming operation on the Weyl-Zuckerman side? A. Yes.

The Court: Did Weyl-Zuckerman have separate farming equipment?

The Witness: Yes.

The Court: On the island?

The Witness: Yes, sir.

The Court: And McDonald, Ltd. had separate——

The Witness: Yes.

The Court: (Continuing) ——farming equipment?

The Witness: Yes.

Q. (By Mr. Livingston): Now, what was the relation—what were the relations between Weyl-Zuckerman and Company and Holly Sugar Corporation with respect to the operations on the McDonald Tract?

The Court: As of what time?

Q. (By Mr. Livingston): As of the period from the date of the acquisition [46] of the shares of stock by the two companies which—or their predecessors which, I believe, was in 1934, 1934 until the date upon which Weyl-Zuckerman and Company purchased the one half—one half of the shares from Holly Sugar Corporation in 19—on March 13th, 1946, which is the period of approximately twelve years?

A. Well, in a general way, they were very good up until some time in 1938 when McDonald Island Farms, Ltd. was in some financial difficulty and

(Testimony of John Zuckerman.)

was making its financial arrangements for the following year.

Mr. Rapetti, who was the manager of Holly Sugar Company and with whom Weyl-Zuckerman and Company had had all their dealing, was in Honolulu at the time and we had to deal with some other members of the company and we were given very cavalier treatment. They made it very difficult for us to secure financing, they threw a lot of difficulties in our way and that was not rectified until Mr. Rapetti returned and again took over the connections that we had with them.

I would say that from about 1939 up until 1941 or so they were good relations with Holly Sugar Company and continued that way up until the time that Mr. Rapetti resigned from the Holly Sugar Corporation. After that time our relations with the Holly Sugar Company were very strained. They wanted to plant sugar beets; we wanted to plant potatoes. They wanted to do many things which we did not want to do, and we had lots [47] of arguments and ultimately culminated in a complete stalemate where we were unable to elect a board of directors in, I believe, I think that year was—well, I can't remember whether it was '43 or '44.

Q. You mentioned in one year you were having a little difficulty in financing McDonald?

A. That is correct.

Q. And a little while ago you told us McDonald's history in credit standing was better than Zuckerman's.

A. That is correct.

(Testimony of John Zuckerman.)

Q. Can you explain the apparent conflict in those two statements?

A. Well, only that it took the cooperation of the two companies in this year 1938, when we had had closest—my recollection is again, this is eighteen years ago, that Weyl-Zuckerman and Company and Holly Sugar Company were called upon that year by the Citizens Bank with whom we were dealing, to guarantee the borrowings of McDonald Island Farms, Ltd., in order to get the money to plant their crops and that Weyl-Zuckerman and Company was willing to guarantee this loan and that the Holly Sugar Corporation was keeping a second deed of trust on the property in return for their guarantee on the note and also a bonus payment of $10,000 and that we called difficulties.

Q. Is it a fact, then, that this was only a temporary [48] situation? A. Yes.

Q. As far as McDonald—— A. Yes, sir.

Q. ——Farms, Ltd. was concerned?

A. Yes, sir.

Q. Well, your last testimony raised another point that I think I would like to clarify. That is, you speak of borrowing the money for crops. Will you kindly explain whether in the farming industry that is a customary financial operation?

A. Well, yes, it is. Under large-scale farming where all of your money goes into the ground in springtime and stays there until the fall when the harvest begins, it is customary all over the West with large and small farming operations to borrow

(Testimony of John Zuckerman.)

the amount of money that you need during that period from a bank.

Q. In other words, it is——

A. Most companies do not have enough working capital to carry them through the year without any borrowing.

Mr. Livingston: That is what I had in mind.

Your Honor, I see it is after 12, and would this be a convenient time for a recess or shall we go ahead?

The Court: Do you wish the noon recess at this time?

Mr. Livingston: I would suggest that, because by [49] this time that stipulation should be ready and I think we should discuss—examine it, at least, before we leave the building.

Mr. Nyquist: I would think, your Honor, it might be another half hour before that might be ready. It is about a four-page typing job. I think if we could go on for another half-hour our stipulation would be in shape.

The Court: Off the record.

(Discussion off the record.)

The Court: I think I will call a noon recess until a quarter to 2.

(Whereupon, at 12:15 p.m., a recess was taken until 1:45 p.m. of the same day.) [50]

Mr. Nyquist: Your Honor, before the examination of the witness resumes, I would like, at this time, to offer a stipulation of facts together with the two returns that are attached as exhibits thereto.

(Testimony of John Zuckerman.)

The Court: The stipulation and exhibits will be received.

Whereupon, John Zuckerman resumed his testimony as follows:

Direct Examination—(Resumed)

Q. (By Mr. Livingston): Directing your attention, Mr. Zuckerman, to the dividend which was declared from McDonald Island Farms, Ltd., with respect to the surface rights, will you state whether Holly Sugar Corporation or Weyl-Zuckerman and Company demanded that declaration of dividend?

A. It was Holly Sugar Company.

Q. And will you state what steps were taken by Weyl-Zuckerman and Company to protect itself against the possible unfavorable consequences of the declaration of that dividend?

A. Well, as a condition to agreeing to the declaration of the dividend the Weyl-Zuckerman Company representatives on the McDonald Island Farms, Ltd. board of directors would not agree to the declaration of the dividend until the Holly Sugar Company had given to Weyl-Zuckerman and Company an option [51] to purchase the lien covered by that dividend.

Q. What was the situation with respect to the declaration of dividend or the proposed declaration of dividend of mineral rights under the McDonald Tract? Who was the one that urged that?

The Court: Now, there, just a moment. There

(Testimony of John Zuckerman.)

have been several dividends involved in this matter and I would like——

Mr. Livingston: You are right.

The Court: Just a moment. I would like the record to be perfectly clear as to just what the testimony is about. Now, when you spoke of Holly, of the demands of Holly, were you speaking of the dividend of August 11, 1943, the one that is dealt with in paragraph V of the stipulation?

Mr. Livingston: Of the surface rights.

The Witness: Yes, sir.

The Court: That is not the dividend that is before us in this litigation, though?

Mr. Livingston: No, your Honor.

The Court: That is a dividend that took place three years earlier?

The Witness: That is correct.

The Court: What has that got to do with this case?

Mr. Livingston: It has this to do with it, if your Honor please, I deem it is valuable for me to show that good [52] faith of these transactions from their very inception. In other words, I want to show that this is a genuine business transaction that was responsible for the condition that prevailed when we reached 1946. It may be somewhat——

The Court: Well, you go ahead.

Mr. Livingston: Yes. Let's see, withdraw that last question. Your Honor's criticism is sound.

The Court: Well, I was just inquiring, I am not criticizing.

(Testimony of John Zuckerman.)

Mr. Livingston: Well, the inquiry is correct because I had not identified it.

I am talking now of the dividend of mineral rights on the McDonald Tract that was made one-half to the Holly Sugar Corporation and one-half to Weyl-Zuckerman and Company, and for your Honor's information, that appears in paragraph VI of the stipulation, the transaction is under date of March 13th, 1946, and I will ask the same question about that dividend.

Q. (By Mr. Livingston): Who was it that insisted upon it?

A. It was the Holly Sugar representatives on the McDonald board of directors.

Mr. Livingston: Now, if your Honor please, I would like to introduce in evidence, but I think we can simplify the matter for the purpose of the record, the minutes of McDonald Island Farms, insofar as they disclose the development [53] of the transactions which eventually led to the declaration of the mineral right dividend. In other words, I don't want to have this evidence depend solely upon the testimony of a witness. The record itself demonstrates these facts upon which I rely, and I have shown these to Mr. Nyquist, and I think if we can simply read into the record certain portions of the minutes it will suffice.

Now, my suggestion is that we begin with the minutes of January 22nd, 1946, of the board of directors of McDonald Island Farms, Ltd., and I read the following:——

(Testimony of John Zuckerman.)

The Court: Well, wait a minute, before you do that, is there any objection on the part of the Government to including portions of the minutes in the record here?

Mr. Nyquist: Well, your Honor, here I object to the time that is being consumed by a lot of background material here that isn't really in controversy. The facts of the dividend and the subsequent option are stipulated and this witness has testified and this is cumulative on a point that really doesn't seem to be in dispute.

Mr. Livingston: I think counsel overlooks one aspect of it.

The Court: Well, apart from your position that it is cumulative, is there any other objection to it?

Mr. Nyquist: No objection to the minutes, your Honor. [54]

The Court: Then why don't you present the minutes in evidence rather than read them into the record?

Mr. Livingston: Then it isn't necessary that the record——

The Court: We can't, as a practical matter. If you mark the portions you want in, I think we can have the Reporter incorporate them in the transcript.

Mr. Livingston: That is what I was about to suggest. I didn't want to read the entire paragraph but merely to identify the particular paragraph on the page on which it appears.

Mr. Nyquist: Your Honor, I will stipulate that

(Testimony of John Zuckerman.)

if he turns the minute book over to the Reporter that there may be incorporated in the transcript the indicated paragraphs from the minutes of the particular meeting that we are referring to here.

The Court: Well, under those circumstances there may be inserted in the transcript, at this point, those portions of the minute book which counsel for Petitioner will identify and make available to the Reporter.

Mr. Nyquist: I request that he identify them by date, at the present time.

The Court: Will you so identify them?

Mr. Livingston: Minutes of the meeting of January 22nd, 1946, those paragraphs appearing on page 45 of the [55] record, paragraphs 2, 3, 4, and 5:

(Whereupon the following was copied into the record as though read.)

"The President thereupon called for a discussion of the second request made by Shareholder Holly Sugar Corporation at said annual meeting of the Shareholders, held on January 21, 1946, that there be declared a dividend in kind of the mineral rights and royalties owned by the corporation on McDonald Island in San Joaquin County, California. After discussion by the Directors, the following Resolution, proposed by Director M. Zuckerman, was unanimously adopted:

"'Whereas Shareholder Holly Sugar Corporation, at the regular meeting of the shareholders held on January 21, 1946 at the office of this corporation, requested that this Board of Directors

(Testimony of John Zuckerman.)

declare a dividend in kind to the shareholders of the corporation of the mineral rights and royalties owned by the corporation on McDonald Island in San Joaquin County, California, and

" 'Whereas this Board of Directors has fully considered such request of said shareholder, and believes that a dividend in kind at this time of the mineral rights and royalties might not be for the best interests of the corporation and its shareholders, [56]

" 'Now, therefore, be it resolved, that no action be taken at this time with reference to said request of Shareholder Holly Sugar Corporation for a dividend in kind of the mineral rights and royalties owned by the corporation on McDonald Island in San Joaquin County, California, and that the same be retained by the corporation until such time in the future when this Board of Directors may deem it advantageous and for the best interests of the corporation and its shareholders that such dividend be declared'."

Minutes of the meeting of March 8th, 1946, the portion of those minutes appearing on page 53, paragraph 5:

(Whereupon the following was copied into the record as though read.)

"The President then informed the Directors that Shareholder Holly Sugar Corporation, had again requested of the Directors that a dividend in kind to the shareholders, be declared out of the earned surplus of the corporation, consisting of the min-

(Testimony of John Zuckerman.)

erals, mineral rights, royalties and royalty rights owned by the corporation on the McDonald Tract, McDonald Island, San Joaquin County, California, and that if such a dividend in kind were to be declared by the Directors of this corporation, the same might be subject to the Corporate Securities Act of the State of California and require a Permit from the [57] Commissioner of Corporations of the State of California. Upon motion of E. L. Dana, seconded by W. H. Ziegler and unanimously carried, the following Resolution was adopted, To-wit:"

And finally, the minutes of March 13th, 1946, on page 69, the third paragraph, beginning with the words, "The President thereupon announced * * *" and the fourth paragraph:

(Whereupon the following was copied into the record as though read.)

"The President thereupon announced that shareholder, Holly Sugar Corporation, had renewed its request to this Board of Directors, originally made on January 21, 1946, that there be declared a dividend in kind of the minerals, mineral substances, mineral interests, ores, oil, gas, asphaltum and other hydrocarbons on McDonald Tract, McDonald Island, San Joaquin County, California, and royalties, royalty rights and proceeds therefrom, including rights, interests and estates, under and by virtue of a Lease and supplemental Agreements heretofore executed by this corporation with The Standard Oil Company of California, a corporation.

"The President then advised the Directors that

(Testimony of John Zuckerman.)

pursuant to the Resolution of this Board of Directors, duly passed at a special meeting of the 8th day of March, 1946, the President and Secretary had caused to be filed [58] with the Commissioner of Corporations of the State of California an Application for a Permit to declare such dividend in kind of said minerals, mineral rights and royalties, and that on the 11th day of March, 1946, a Permit approving such dividend in kind was issued by said Corporation Commissioner."

Mr. Livingston: That is all I will put in. I will put in some pages here so we can identify it easily. Now, I offer in evidence, if the Court please, the deed of trust——

Mr. Nyquist: Wait a minute.

Mr.Livingston: Pardon me. Did you want to say something?

Mr. Nyquist: I just wanted to check on that last page you identified here. I presume that relates solely to the dividend in kind, is that correct?

Mr. Livingston: Yes.

Mr. Nyquist: Very well.

Mr. Livingston: The deed of trust dated May 20, 1946, the McDonald Island Farms, Ltd. to Corporation of America, Trustee, and Bank of America National Trust and Savings Association as beneficiary. Counsel has seen this and has agreed that I may use it. And, in connection with that——

The Court: Just a moment.

Mr. Livingston: I beg your pardon? [59]

(Testimony of John Zuckerman.)

Mr. Nyquist: No objection to that, your Honor.

The Court: Be admitted.

The Clerk: No. 3.

Mr. Livingston: And in connection with that, a letter signed by McDonald Island Farms, Ltd., dated June 15th, 1946, addressed to the Bank of America showing the acceptance by the Vice President of the Bank of America. That likewise has been exhibited to counsel.

Mr. Nyquist: No objection, your Honor.

The Court: Be admitted.

The Clerk: Exhibit 4.

(The deed and letter were marked and received in evidence as Protestant's Exhibits Nos. 3 and 4.)

The Court: Now, what property is covered by Exhibit 3?

Mr. Livingston: Exhibit 3 covers——

The Court: In your view?

Mr. Livingston: Beg pardon?

The Court: In your view?

Mr. Livingston: It covers all of the surface rights of the McDonald Tract, all of the surface rights of Henning Tract. Your Honor will find——

The Court: Any subsurface rights?

Mr. Livingston: None at all, your Honor. Your Honor will find they are specifically excepted.

Q. (By Mr. Livingston): Now, referring to the subject matter of the Court's [60] last comment, inquiry, will you explain the facts with respect to

(Testimony of John Zuckerman.)

the exclusion of the mineral rights from the deed of trust?

Mr. Nyquist: Your Honor, I request that that question be clarified, "Will you explain the facts." If he is to state the facts——

Q. (By Mr. Livingston): All right, state the——

Mr. Nyquist: I don't know what he means by way of explanation of facts.

Mr. Livingston: Withdraw that question.

Q. (By Mr. Livingston): State what facts there were at the time of that transaction leading up to the exclusion of the mineral rights from the deed of trust?

A. Well, this deed of trust was given by McDonald Island Farms, Ltd., who did not own the mineral rights to the McDonald Tract. They specifically excluded the mineral rights which underlay the Henning Tract, even though they owned them, because that was the condition under which the loan arrangement with the Bank of America had been made.

Q. And what, if any, were the reasons for arranging that the mineral rights on the Henning Tract were not to be transferred in trust as security for this Bank of America loan?

Mr. Nyquist: I ask that we again specify whose [61] reasons?

Q. (By Mr. Livingston): The reasons of the corporation that is involved. That is, McDonald Island Farms.

A. They wanted the income.

(Testimony of John Zuckerman.)

Q. What do you mean by that, "they wanted the income?"

A. From the gas, oil there that was going to be produced. There was income coming from it and they wanted the income.

Q. Now, in the month of June, 1946, were there any conversations with the Standard Oil Company or any representative of the Standard Oil Company or the Pacific Oil Company or any representative of the Pacific Oil Company with respect to a sale of mineral rights?

A. There were none by us.

Q. And had there, at any time prior to that, been a—Strike that, please.

Was there a conversation in November, 1945, on that subject? A. Yes.

Q. Was there any conversation at any time after November, 1945 on that subject and prior to June 27th, 1946? A. No, sir.

Q. And will you state what was said in the conversation of November, 1945, in substance? [62]

A. Well, to the best of my recollection, Mr. Schroeder.

Q. Who is Mr. Schroeder?

A. Head of the Land and Lease Department of the Standard Oil Company, made an offer to either my father or me or both of us, I can't remember which, in which he said that they would be willing to purchase the entire rights, mineral rights, that is both under the Henning Tract lease and the McDonald lease in the amount of $500,000.

(Testimony of John Zuckerman.)

Q. And what answer was given to that?

A. We told him that we did not own the mineral rights in their entirety, and if we did we wouldn't want to sell them.

Q. Now, was there a conversation on the subject of purchasing the mineral rights after June 27th, 1946?

A. Well, I don't know of any. I understand there was, but I wasn't a part of them.

Q. At all events, will you state what was the situation between the Standard Oil Company and McDonald Island Farms, Ltd. and Weyl-Zuckerman and Company in the months of June, July, and August, 1946?

A. Well, there was a condition of extreme enmity.

Q. Will you explain—give us the facts in that regard, please?

A. Yes. The percentage of the production from the entire McDonald gas field that was being paid was being paid [63] under what the Standard Oil Company calls a rateable tax plan.

I would like to explain, for the purpose of clarity, that in this gas field there were other people, property involved than McDonald Island Farms and Weyl-Zuckerman and Company. There were two leases, the Mayberri and the Ilden lease.

Q. Well, clarify that even further, if you don't mind. Explain what you mean by a gas field and the participation of these four different entities in the production of that field?

(Testimony of John Zuckerman.)

A. Well, I am no geologist, but the entire area there from which gas was being produced was called the McDonald Gas Field or the McDonald Field. Part of that, according to the Standard Oil, underlay the McDonald Tract, part of it underlay Henning Tract, part of it underlay Wiskey Slough, and part of it underlay the land of the property held under the Mayberri and the Ilden community lease and they were producing wells under each of these properties and the Standard Oil agreed to pay each person their fair and equitable share.

Q. You say they were producing wells on each of these four parcels?

A. Yes, sir.

Q. Were those producing wells drawing off gas that was held in common under all four pieces of property? A. Yes. [64]

Q. Then the problem, as I understand it, was —correct me if I am wrong—to determine the correct allotment to be paid for the four different land owners for gas that was so produced?

A. That is correct.

Q. Go on.

A. That they did under what they called the rateable tax plan and at the inception of the production of the field, which was in '37 or '38, they assigned a certain percentage of this income to Weyl-Zuckerman and Company, a certain percentage to McDonald, and a certain percentage to Mayberri, and a certain percentage to Ilden.

After that time they steadily diminished the per-

(Testimony of John Zuckerman.)

centage paid to Weyl-Zuckerman and Company and increased the percentage, at various times, paid to either Mayberri and Ilden. Weyl-Zuckerman and Company objected strenously to that throughout because it was under a very nebulous plan. It was based on two things. One, as I have stated, with relation to the area underlying the properties, the other with what they called a productivity or the producibility of the wells. That, I have no conception of what that means, but those were the factors that they said were involved.

Consequently, whereas they started off paying Weyl-Zuckerman and Company a twenty-four and some fraction—may I refer to some papers I have here, your Honor, that have [65] these particular figures?

The Court: You may refresh your recollection.

Mr. Nyquist: Your Honor, if it will help to expedite this, I will stipulate there was a dispute between petitioner and Standard Oil about the allocation of gas to be taken from these various stations.

Mr. Livingston: I accept the stipulation as to that.

Now, then, is counsel willing to stipulate as to another source of controversy between the Standard Oil Company and Weyl-Zuckerman and Company and also McDonald Island Farms which involved the obligation of the Standard Oil Company to drill offset wells? Are you in a position to stipulate on that?

(Testimony of John Zuckerman.)

Mr. Nyquist: Yes, there was a dispute there. I will so stipulate.

Mr. Livingston: And the fact is—Let's see if the stipulation encompasses——

The Court: Have you fixed the time of this so-called dispute?

Mr. Livingston: Will you help us in that respect?

The Witness: This was continuously, but more particularly in '46 when we were threatening to sue the Standard Oil Company.

Mr. Livingston: All right, and then let us [66] stipulate, if we may, that this controversy existed in the year 1946, controversy being that the Standard Oil Company had drilled on the Mayberri property, what was known as Mayberri Well No. 2.

Mr. Nyquist: I am not prepared to stipulate to all of these details. I am just stipulating that there was a dispute that gives you your background, doesn't it?

Mr. Livingston: It does, and I appreciate it.

Q. (By Mr. Livingston): Isn't it a fact that the Standard Oil Company had drilled a well on the Mayberri property which is known as Mayberri No. 2? A. Yes.

Q. All right. Now, what was the location of that well with respect to the property line?

A. It was so close to the property line that we felt that there was an offset well should be drilled, certainly on the McDonald Tract and possibly on the Henning Tract.

(Testimony of John Zuckerman.)

Q. And did you make those representations to the Standard Oil Company? A. Yes, sir.

Q. What did the Standard Oil Company do about it?

A. Well, they returned me a map, Mr. Schroeder again sent me a letter saying that this map represented the distances and he showed on the map that the Mayberri well was 800 feet [67] from the nearest boundary of the McDonald property and 1400 feet from the nearest boundary of the Henning property; also hired an independent engineer and had him make surveys and found these distances were much less, and at that time, which I think was August or September or October of 1946, we began to prepare a case to sue the Standard Oil Company to force them to live up to their contractural obligations.

Q. And specifically, to drive an offset well where? A. On the McDonald Tract.

Q. Yes.

The Court: And will you fix the time again, please, for that?

The Witness: Well, sir, it was in August or September or October of 1946 and I think it was in all of those months; by which I mean I was conferring with attorneys, I was having measurements made, I was doing a great number of things that required time during those three or four months, and some of the communication about the distances took place as early as, I believe, April of 1946.

Q. (By Mr. Livingston): Now, then, was there

(Testimony of John Zuckerman.)

an offer made or a conversation in the month of December, 1946, on the subject of the prospective lawsuit and of the possibility of a sale to avoid a lawsuit? A. Yes. [68]

Q. And who participated in that conversation?

A. George Schroeder and I.

Q. And can you recall where that conversation took place?

A. In Mr. Schroeder's office in the Standard Oil Building, in San Francisco.

Q. Now, can you give us the substance of the conversation insofar as it related to this prospective lawsuit and the possibility of sale?

A. The only substance that I can remember is that I told him that we would rather settle the matter amicably rather than go to the expense and the trouble and bother of a lawsuit.

Q. And what did he say?

A. He then suggested that they might talk purchase of the entire field. I said that that would be perfectly satisfactory, and then he said that they would not now offer $500,000, that they had offered it the previous November because there had been royalties paid in the interim, and I said that 500,000 was way too low, anyway, and that it should be raised, and he said to how much, and I said, $650,000, and he said that he would take the matter up with his superiors on that basis, $650,000 for the entire field that underlay McDonald Island. That is both the McDonald Tract and the Henning Tract.

(Testimony of John Zuckerman.)

In other words, it would be a lump sum purchase so there were other things discussed, I don't remember all of them, but this was the substance of that discussion. [69]

The Court: In what capacity were you negotiating with Mr. Schroeder?

The Witness: Well, the representative of our stockholders.

The Court: By "our" you mean whose?

The Witness: I don't understand that question, sir.

The Court: Well, we have got both corporations involved here. We have got Weyl-Zuckerman and Company, we have got McDonald Island Farms, Ltd.

The Witness: Well, I was Weyl-Zuckerman and Company's representative.

The Court: You were Weyl-Zuckerman's? The record may show this, but I—it has been shown in testimony, my recollection is not very good at this point, but were you an officer of Weyl-Zuckerman as well as in McDonald?

The Witness: I was the manager.

The Court: Of both of them?

The Witness: I was the president of McDonald Island Farms and the manager of—I did everything. I can't——

Q. (By Mr. Livingston): Well, the manager of what?

A. Weyl-Zuckerman and also the manager of McDonald Island Farms.

(Testimony of John Zuckerman.)

Q. Well, to clarify it for the Court, let's analyze that a little further. [70]

As manager of the Weyl-Zuckerman and Company you were operating the Utah and Oregon farming endeavors of that company?

A. Yes, sir. Yes, sir.

Q. Is that right? A. Yes.

Mr. Nyquist: Your Honor, this is a point on which I don't think we should have leading questions.

Mr. Livingston: Well, I think it is already in evidence, your Honor. I just want to pinpoint it. However, I won't ask the leading questions.

Q. (By Mr. Livingston): In your position as manager of McDonald Island Farms, what were you actually doing?

A. I was running the company.

Q. But explain to the Court what the company's activities were?

A. It was farming. I was out supervising the farming, the planting, the harvesting of the crops, and everything that goes with the 6,000 acre farming project.

Q. Where?

A. In Stockton at McDonald Island.

The Court: When Mr. Schroeder dealt with you, I take it he understood you were in a capacity one way or the other to bring about a consummation of the activities involving these [71] mineral rights whether through one corporation or through the other?

(Testimony of John Zuckerman.)

A. Well, I did tell him that anything, naturally, that came up, I had to refer to the board of directors who had the power to act, but I was the messenger, at least.

Q. Now, did that conversation eventuate into a sale—strike that, please.

Was there a subsequent conversation or information from the Standard Oil Company as to whether this deal could be made?

A. Yes, sir.

Q. Now, at that time the mineral—Pardon me, your Honor.

At that time the gas rights under Henning Tract were owned by McDonald Island Farms, Ltd., were they not?

A. Yes, sir.

Q. And at that time the gas rights under the McDonald Tract were owned by Weyl-Zuckerman and Company, is that correct?

A. Will you say that again, please?

Q. At that time the gas rights under McDonald Tract were owned by Weyl-Zuckerman and Company? A. Yes, sir.

Q. Yes. Now, in terms of thirteenths, can you tell us what the relative proportion was of the rights under the two [72] tracts?

A. Well, the rights underlaying the McDonald Tract were approximately 8/13ths and the rights underlying the Henning Tract were approximately 5/13ths. That is, in their relationship to each other.

Q. Yes. Now, will you state whether a dividend

(Testimony of John Zuckerman.)

of those mineral rights on the Henning Tract was declared by McDonald Island Farms, Ltd.?

A. Yes, there was, in December, some time, I don't know.

Q. And will you state whether that was done in connection with the prospective sale of those mineral rights but—those mineral rights to the Standard Oil Company or its designee?

A. Well, we knew we were going to sell at that time.

Q. And had you, in the meantime, been informed by Mr. Schroeder that a deal could be made or approximated? A. Yes.

Mr. Livingston: I think you asked us to produce the deed to the Pacific Oil Company, Mr. Nyquist.

Q. (By Mr. Livingston): Now, I have just showed counsel a deed from Weyl-Zuckerman and Company from Weyl-Zuckerman—from—Pardon me, just a minute, if your Honor will indulge.

I have here a deed from Weyl-Zuckerman and Company to Pacific Oil Company covering the mineral rights that have [73] been the subject of your testimony. How does it happen that the Pacific Oil Company was named as the grantee?

A. I don't know.

Q. I mean, were you told anything on that subject?

A. I don't recall anything. All I know is that when the Standard Oil Company came to do business they dealt in the name of the Pacific Oil Company.

(Testimony of John Zuckerman.)

Q. That is what I am trying to develop. They told you that the transaction would be handled by the Pacific Oil Company?

A. That is correct.

Q. And now will you state the reasons why the dividend was declared by McDonald Island Farms of the mineral rights that were under Henning Tract?

Mr. Nyquist: Will you repeat that question, please.

Mr. Livingston: Mr. Reporter, please.

(Whereupon the question was read by the Reporter.)

A. This was the dividend in December of 1946?

Q. (By Mr. Livingston): Yes.

A. Well, that was done, No. 1, to put all of that —all of the mineral rights into one group so that we could transfer the title, so that—I say "we," so that Weyl-Zuckerman and Company could transfer that title to the Pacific Oil Company as one unit which the—the Standard Oil Company had indicated [74] that they were only interested in buying the entire gas rights, and there is a reason for that that I would like to state, if I might.

Q. All right, go ahead.

A. They indicated at that time that they had some intention of bringing—I don't like to further complicate this, but of bringing gas in from Texas in a pipeline, and they wanted to store gas from Texas under McDonald Island. Therefore, only a portion of that right would do them no good. They

(Testimony of John Zuckerman.)

had to have the ability to control that gas field as they saw fit, and they wanted the entire area under their control so they could do anything they pleased with it without having any stock—stock, or land or leaseholder rights to——

Q. Complicated? A. Complicated.

The Court: Well, assuming that that is true, all those rights could have been transferred to Standard by two deeds instead of one?

The Witness: Yes.

Q. (By Mr. Livingston): Now, go ahead and explain why the McDonald Island Farms, Ltd. didn't make the transfer direct to the Pacific or the Standard Oil Company?

A. Well, one very good reason we had is we didn't want to come under the provisions of an agreement that we had with [75] the Bank of America in connection with our deed of trust.

Q. Well, had you — will you explain that, please?

A. Yes. At the time, I, as president of McDonald Island Farms, Ltd., negotiated the loan from the Bank of America of $720,000. It was a ten-year loan. That is, it was to be repaid in ten years. We were to pay an annual installment of some $28,000 on part of the principal with interest at the rate of 4%.

There was a further agreement made that in any year where our profits, and I say "our" meaning McDonald Island Farms, Ltd., after taxes but prior to depreciation being taken off, exceeded the $28,000, that they were to receive each year, we would

(Testimony of John Zuckerman.)

pay them 35% of such profit towards the retirement of the bonded indebtedness.

Had we done that——

Q. "Had we done * * *" what?

A. Had we come under that—had we had—had the sale of these gas rights been made by McDonald, they would have shown a substantial profit which would have been subject to this provision and, it is my understanding from our accountants, that that would have necessitated the payment of about $50,000 to the Bank of America, which, by virtue of the dividend being in the hands of Weyl-Zuckerman Company, was not payable.

Q. What was the condition of McDonald Island Farms at [76] that time, the financial position of McDonald Island Farms at that time with respect to its ability to find $50,000 in cash for that purpose? A. Well, it was not easy to find.

Q. Did the company have it available?

A. I don't think so. I don't remember. I don't think so.

The Court: You are speaking about the cash availability prior to the proposed sale to Standard Oil or Pacific Oil?

Mr. Livingston: Yes, your Honor. Now, the next——

The Court: It seems to me the true question is, what would the value be after the sale, not before.

Mr. Livingston: I am about to do that.

Q. (By Mr. Livingston): What was done—Strike that, please.

(Testimony of John Zuckerman.)

The purchase price received from the Standard Oil was approximately 690,000, isn't that right?

A. Yes.

Q. That was received by Weyl-Zuckerman and Company? A. Yes.

Q. What was done with that?

A. Used to pay debts with.

Q. All of it? A. Yes. [77]

Mr. Livingston: I have the record here, your Honor, for the purpose of demonstrating that these financial exigencies existed and to show the disposition of all this money to support Mr. Zuckerman's testimony in that respect.

I would like to offer in evidence——

The Court: But that was money received by Weyl-Zuckerman after the dividend had been declared. Now, if that dividend had not been declared and the mineral rights which McDonald held had been sold directly to Standard, McDonald would have had the proceeds of that sale?

Mr. Livingston: That is correct. Not all of it.

The Court: Not all of it, but that portion of the proceeds attributable to the mineral rights that were in McDonald and that portion of it would have been more than adequate, I take it, to make payment on principal to the Bank of America?

The Witness: That is correct.

Mr. Livingston: And——

The Court: And Zuckerman would have had any interest in that?

Mr. Livingston: That portion, but while——

(Testimony of John Zuckerman.)

The Court: Just a minute. I am addressing myself to the witness. And—well, there would have been no problem whatever, then, would there?

The Witness: Yes. Well, do you want me to answer? [78]

The Court: Yes, I do.

The Witness: The problem would have been that we would have had to turn over to the Bank of America $50,000 which was badly needed in our business.

The Court: "We," you are now referring to McDonald?

The Witness: McDonald, yes, sir.

Mr. Livingston: Which was badly needed in the business?

The Witness: You mean in McDonald's business?

Q. (By Mr. Livingston): Yes, by virtue of this defendant not coming—or, I beg your pardon, of the sale price not coming to McDonald, did not become payable to the Bank of America?

The Court: Well, how was any of that proceeds available to McDonald? I understood that as a result of the dividend McDonald lost everything in connection with these mineral rights?

The Witness: Yes, sir.

Q. (By Mr. Livingston): The mineral rights went up to——

A. That is right, and that is where they were needed.

The Court: Well, you are talking about the needs of Weyl-Zuckerman, not the needs of McDonald, or

(Testimony of John Zuckerman.)

are you? You tell me what you are talking about.

The Witness: I don't want to appear stupid on this, [79] but there were various intercompany debts. One company owed another. There were advances made. I can't say at this moment what McDonald's debts were at that time but that was handled by another member of our company.

The thing that I do know is that that $50,000 was badly needed in our business and we did not want to have it go out at that time. It was needed in McDonald, it was needed in Weyl-Zuckerman and Company, it was needed in all of our operations because 1946 had been a very bad farm year.

Q. (By Mr. Livingston): All right. One thing has been clarified and that is that you desired to avoid the obligation to pay $50,000. That is, McDonald's obligation to pay $50,000 to the Bank of America which would have been due if the—if McDonald had made the sale direct. That is clear, but the Court has another problem in mind. The Court suggests that if McDonald had made the sale McDonald would have had, at least temporarily in its possession, say, a couple of hundred thousand dollars representing the purchase price of the rights that were under the Henning Tract, so I would like you to explain to the Court why that money was needed and how it would have had to be used, regardless of who the recipient was?

A. I don't think I can answer that.

Q. You think Mr. Von Husen can?

A. Yes. [80]

(Testimony of John Zuckerman.)

Mr. Livingston: I offer this in evidence. This is the deed from Weyl-Zuckerman and Company to Pacific Oil Company.

Mr. Nyquist: No objection.

The Court: Admitted.

The Clerk: Exhibit 5.

(The deed referred to was marked and received in evidence as Protestant's Exhibit No. 5.)

Mr. Livingston: You may cross-examine.

Cross Examination

Q. (By Mr. Nyquist): Mr. Zuckerman, will you please enumerate the different partnerships and entities that were owned and held by the Zuckerman family during these years 1946 and 1947?

Mr. Livingston: You mean exclusive of strangers who are employees? In other words, you are confining it to the blood members, members of blood of the Zuckerman family?

Q. (By Mr. Nyquist): Let us say that we are confining it to members of the Zuckerman family during this period?

A. Are you referring to my family?

Q. Let's clarify that. Who is Maurice Zuckerman? A. That is my father.

Q. Is he the Zuckerman whose name was used in Weyl-Zuckerman Incorporated?

A. Yes. [81]

Q. And what was his relationship to that company? A. President.

(Testimony of John Zuckerman.)

Q. From its beginning throughout the years in controversy here? A. Yes.

Q. In the period of 1907 to 1946, thirty-nine years, and there was another corporation, Maurice —rather, M. Zuckerman, Inc., was that corporation also named after your father Maurice Zuckerman?

A. Yes, sir.

Q. And it was a stockholder in Weyl-Zuckerman, Inc.? A. Yes, sir.

Q. And then who were the officers of McDonald Island Farms in the years 1946 and 1947?

A. Well, I was president. This is my recollection, I believe that my father was vice president. I think Von Husen was secretary, that is—no—well, either he or one of the representatives of the Holly —no, that is right, during '46 and '47, that is correct.

Q. And did your father Maurice Zuckerman take an active part in the management of these businesses? A. Yes.

Q. Was he, in fact, the dominating individual in the management of these businesses throughout this period?

A. I don't think we had any dominating individuals. [82]

Q. When you testified on direct examination about the purposes or events which motivated certain actions on the part of these corporations, were those matters of which you had personal knowledge or which you had been told?

(Testimony of John Zuckerman.)

A. I think I had personal knowledge of everything that I discussed.

Q. You think you had? Did you have personal knowledge during these years 1946—well, during the year 1946? A. Of the what?

Q. Of the various reasons to which you testified that motivated the various transactions at that time? A. Yes, sir.

Q. And did you, at that time, understand those reasons? A. Yes.

Q. You are now the president of Weyl-Zuckerman and Company? A. No.

Q. You are an officer now?

A. No, there is no Weyl-Zuckerman.

Q. Oh, there is no Weyl-Zuckerman. I see. Well, you mean it was dissolved when?

A. In 1952, in September.

Q. In September of 1952?

A. That is correct.

Mr. Nyquist: That was after the date of the filing [83] of the petition in this proceeding, your Honor. I don't think that would be a complicating factor. I think under California law a corporation remains alive for five years for purposes of winding up, so I don't believe that the dissolutioning of the petitioner—it is my opinion in this matter that that would not complicate this matter.

The Court: Have its assets been completely distributed?

The Witness: Yes, sir.

Mr. Nyquist: We might have a transferee prob-

(Testimony of John Zuckerman.)

lem, although I think perhaps it is just as well if we get the transferor's liability fixed, anyway.

Q. (By Mr. Nyquist): Mr. Zuckerman, we issued a subpoena before we knew about the dissolution of Weyl-Zuckerman, and we thought we had served it on Weyl-Zuckerman to bring in certain books of accounts. Are they in the courtroom?

Mr. Livingston: We are responding to that subpoena. We are not——

Mr. Nyquist: It might facilitate matters if the revenue agent and the—Mr. Van Husen could locate the things that we are looking for in those books and not take the Court's time. I will just tell the agent what I am looking for.

Q. (By Mr. Nyquist): Mr. Zuckerman, concerning the transfers of surface rights in the Henning Tract to McDonald Island Farms, Ltd., in June of 1946, I understood your testimony on direct examination to be that one-third of that tract was already owned by McDonald, McDonald Island Farms, Ltd., is that correct?

A. Will you repeat your question?

Mr. Nyquist: I will ask the Reporter to read it.

(Whereupon the question was read by the Reporter.)

A. No, that is not correct.

Q. (By Mr. Nyquist): Let me get this straight. In June of 1946 didn't McDonald own one-third of the—Oh, I see. I referred to the Henning Tract. I should have referred to the McDonald Tract.

Now, I will ask you the same question with re-

(Testimony of John Zuckerman.)

spect to the McDonald Tract. Prior to these transfers in June of 1946, was it your testimony that McDonald Limited owned one-third of the surface rights in the McDonald Tract?

A. Yes, sir.

Q. Are you sure of that? A. Yes.

Q. And Weyl-Zuckerman owned one-third of the surface rights in the McDonald Tract which was transferred to McDonald, Limited in June of 1946, was that your testimony?

A. I think it was.

Q. And you are sure of that? [85]

A. I—I'm getting to the point where I'm not sure about anything about this now.

Q. And you said that one-third of the McDonald Tract was owned by the Zuckerman Potato Company, a partnership? A. Yes.

Q. And that the Zuckerman Potato Company transferred its one-third to McDonald Island Farms at the same time in June of 1946, was that your testimony? A. Yes.

Q. And you are sure of that?

A. Well, it is my best recollection.

Q. I call your attention to Exhibit 1-A, Corporation Income Tax Return of Weyl-Zuckerman for the Year 1946, Schedule C. Sales of Capital Assets, and I call your attention to an item appearing thereon under the caption, "Sold to McDonald Island Farms, Ltd., wholly owned subsidiary, land, Henning Tract * * *" followed by certain amounts, and also the statement, "Two-thirds undivided in-

(Testimony of John Zuckerman.)

terest in the surface rights to the McDonald Tract."

Now, I ask you whether that may refresh your recollection as to who owned the McDonald—the surface rights in the McDonald Tract prior to these transfers to McDonald Island Farms in June of 1946?

A. Well, it would seem to indicate that it was owned by Weyl-Zuckerman and Company. [86]

Mr. Livingston: What was that last?

(Record was read by the Reporter.)

Q. (By Mr. Nyquist): Do you recall who owned it?

A. Well, I know that it was owned by Zuckerman Potato Company—You are talking about the one-third that I referred to?

Q. For the—so that the witness will not be unduly confused, I call his attention to the fact that paragraph 5 in the stipulation touches in part upon this. It says that:

"As of August 11, 1943, McDonald, Ltd. declared a dividend in kind to its stockholders, as the result of which Weyl and Holly each received a one-third (⅓) interest in the surface rights of the McDonald Tract * * *"——

A. Oh, I can answer that.

Q. You can answer it now?

A. No, go ahead please, will you? I am still confused.

Q. "* * *McDonald, Ltd. retaining the remaining one-third (⅓) of the surface rights and all of the mineral rights. As of about the same date Holly

(Testimony of John Zuckerman.)

gave Weyl an option to purchase Holly's said one-third (⅓) interest in said surface rights for $120,-280.30. Said option was transferred to Zuckerman Potato Co., a partnership, which exercised it and Holly conveyed to Zuckerman Potato Co. on December 27, 1944. [87]

So, as of December 27th, 1944, we have one-third in each of the three entities, Zuckerman Potato Company, the partnership; one-third in McDonald Island Farms; and one-third in Weyl-Zuckerman. But, did something occur in between those dates whereby Weyl-Zuckerman had acquired two-thirds of it at the time of the sale to McDonald Island Farms? A. I don't remember.

Q. Are your income tax returns prepared from the books and records of the company?

A. Yes, sir.

Q. Well, I— as between your recollection in the matter and your income tax return, which would you be inclined to believe would be correct?

A. The income tax return.

Mr. Nyquist: Thank you.

(Discussion off the record.)

Q. (By Mr. Nyquist): On direct examination you testified as to reasons for putting all of the McDonald Island into the hands of the—or into the McDonald Island Farms, Ltd., and one class of reasons that you stated was what you called financial reasons, and I understood your testimony to be that Zuckerman Potato Company was engaging in certain risky operations, is that it? A. No.

(Testimony of John Zuckerman.)

Q. Weyl-Zuckerman was engaging in certain risky [88] operations? A. That is right.

Q. And you wished—that is, the people in control of the two corporations wished to put the operations that were not considered so risky in the hands of the one corporation, which was McDonald Island Farms, so that they would not be subject to the risk that was involved? A. No, sir.

Q. Will you explain that, then? Perhaps I didn't understand it.

A. All farming is a very risky venture, which you must know.

Q. Yes.

A. And, we sometimes may wish to separate our risks in the one instance. The other thing was that these—you take operations that were a new venture, they were untried—I think I used the word untried rather than risky.

Q. Yes.

A. That is, if that is what you want, the explanation of the word "risky" I said "untried."

Q. Untried? In other words, you considered there were possibilities of heavy loss there?

A. Yes.

Q. And you didn't want to subject the property to those hazards, is that it? [89]

A. That is one reason.

Q. And you understood these were the reasons that you understood at that time?

A. Yes, some of them. There were many others.

Q. Well, I have seen occasions when a corpora-

(Testimony of John Zuckerman.)

tion would put risky, hazardous properties in the hands of a subsidiary so that the parent corporation wouldn't be subject to the risk of the subsidiary's business, but could you explain to the Court how you intended that would work when these risky businesses were in the hands of the parent company?

A. We had no way of working anything. That is a way of separating the business.

Q. One of these you testified to on direct examination is, you considered these Utah operations somewhat uncertain and risky, and you wanted to, more or less, insulate them from the other operation? A. Yes.

Q. Now, I am asking what you accomplished by putting them in the hands of the parent corporation? Who are you protecting from what?

A. We wanted—we didn't want to protect anybody from anything. We did what we wanted. We separated them from McDonald Island Farms.

Q. What was the purpose of this separation again, this financial purpose we are discussing? Will you explain that [90] financial purpose with respect to the Utah operation?

A. There are many, in addition to the one I said. One is——

Q. Let me call your attention—I am referring now only to your testimony about these operations up in Utah or Idaho, whichever you stated.

A. The minute we began operating in Utah we were subject to Utah State income taxes, as you

(Testimony of John Zuckerman.)

know. By keeping the Utah operation or the California operation separate from the Utah operation they did not get involved in our Utah State income tax return, neither did they get involved in our Oregon State income tax return. That was one financial reason, so as not to complicate our picture.

The other was to have the Stockton farming operations conducted by a separate corporation wholly on its own, able to do its financing without the untried operations being included in its activities.

Q. Well, didn't you testify on direct examination that you considered these untried operations, that there was considerable risk of loss in those operations?

A. I probably described them as being risky, yes, or untried.

Q. And was that one of the reasons you gave for segregating the assets of the two corporations in this way? A. Yes, yes. [91]

Q. And are you able to offer any further explanation as to what you had in mind as to the purpose, in putting the risky, the operations which you termed the risky or the uncertain ones in the hands of the parent corporation?

A. No more than what I have said. I could—I could add something to that. I mean, if you want more reasons there are many of them.

Q. No, I am merely after a clarification of this one reason we were talking about.

(Testimony of John Zuckerman.)

A. I thought I gave sufficient reasons, but there are many more.

Q. Now, in connection with the sale of the two-thirds interest by Weyl-Zuckerman to McDonald Island Farms in 1946, this purported sale in June of 1946 of a two-thirds interest—No, wait a minute. Excuse me. I misspoke myself.

In connection with this sale of the entire Henning Tract and the sale of the two-thirds interest in the surface rights of the McDonald Tract by Weyl-Zuckerman to McDonald Island Farms in June of 1946, was the purchase price paid in cash?

A. I don't remember.

Q. Turning now to the negotiations with Standard Oil, who represented the petitioner and the related corporation in those negotiations?

A. I don't—I am sorry, I don't know who the petitioner [92] is.

Q. Weyl-Zuckerman.

A. Okay, and at what time, sir?

Q. In the negotiations—throughout the negotiations, at any time throughout the negotiations, between the owners of these lands and Standard Oil Company for the—that ultimately led up to the sale in January, 1947?

Mr. Livingston: Objection, assuming something not in evidence. There is no testimony there were negotiations. There was testimony to two conversations.

Mr. Nyquist: There was testimony as to an offer and a counter-offer, your Honor.

(Testimony of John Zuckerman.)

Mr. Livingston: No, your Honor, I dispute that. The testimony is that in November, 1945, Mr. Schroeder said $500,000 and the answer was "Refused, as we do not own them." All testimony was that in December of 1946 Mr. Schroeder said, $500,000 too much; Mr. John Zuckerman said it is not enough, and the suggestion was made of six fifty.

The Court: Well, that sounds like a negotiation to me.

Mr. Livingston: Well, it doesn't sound like it to me, your Honor. Negotiation, my conception of it is a series of conversations in which parties were engaged, one with the other, and which the objective, which is in mind, is never fully abandoned. [93]

The Court: I think you are quibbling. The question obviously relates to these discussions, and I think it sufficiently identifies them.

Q. (By Mr. Nyquist): Will you answer that question, please? A. What was it?

Q. Who represented the Weyl-Zuckerman Company and/or McDonald Island Farms in negotiations or conversations, if you prefer, which led up to the sale, which is the subject of this controversy?

A. And when, sir?

Q. At any time during the negotiations? I will make the question a little broader.

Who, at any time, discussed with Standard Oil the possibility of selling to Standard Oil the remainder of the gas rights which were retained—which were owned by Weyl-Zuckerman and McDonald Island Farms?

(Testimony of John Zuckerman.)

A. Well, I presume Holly Sugar people, Maurice Zuckerman, I.

Q. Do you know whether—Were you present at all conversations? A. No.

Q. There were conversations at which you were not present?

A. I don't know, but at the negotiation at which I was [94] present I represented Weyl-Zuckerman.

Q. Was Maurice Zuckerman with you on any of those occasions?

A. Not to my recollection. I would, again, like to repeat this was nine or ten years ago and some of these things aren't as clear as they could be.

Q. After the sale had been agreed upon, or after the terms of the sale had been generally agreed upon and it came time to agree upon the mechanics of the sale, the course the conveyances were to take, whose suggestion was it that the gas rights all be transferred to Weyl-Zuckerman and from Weyl-Zuckerman to Standard Oil's subsidiary?

Mr. Livingston: I think counsel makes an error in that respect, not intentionally. All the gas rights were not transferred to Weyl-Zuckerman and Company. Weyl-Zuckerman and Company at this time owned what we determined to be 8/13ths of it. It is only the 5/13ths.

Mr. Nyquist: The sentence was not phrased very aptly.

Q. (By Mr. Nyquist): In which the gas rights were transferred to Weyl-Zuckerman, so that Weyl-Zuckerman could convey all the rights which were

(Testimony of John Zuckerman.)

being sold to Standard Oil, who suggested that procedure?

A. It was the result of mutual discussion.

Q. But my question was, who suggested that the transfer [95] take that indirect rather than direct course? A. I don't know.

Q. Were you there?

A. Not knowing just when the suggestion was made, I don't know whether I was there or not. I know I was in on all of these deliberations and determinations so I must have been there.

Q. Well, did Standard Oil make any suggestion as to how the—the direction the conveyances should take? A. No.

Q. Did you, or any of those representing your side, make any suggestion?

Mr. Livingston: To whom, you mean Standard Oil?

The Witness: I don't understand the question. I am sorry.

Mr. Livingston: I would like——

Mr. Nyquist: The point——

Mr. Livingston: Pardon me, go ahead.

Mr. Nyquist: The point is, once a deal had been made with Standard, Standard was to purchase these gas rights at a certain total figure which was allocable between the two tracts and at an agreed basis; there came the matter of putting the deal into effect, making the conveyances. In the ordinary course of business a seller conveys to a buyer, or whoever has the property conveys to whoever is

(Testimony of John Zuckerman.)

going to get it, but [96] here we have the extra step in the proceeding of McDonald Island Farms making a transfer to Weyl-Zuckerman which then made a transfer to Pacific Oil Company, the subsidiary of Standard.

Now, I am trying to find out how that got into the picture, who suggested it. Is that clear?

A. It is clear, yes.

Q. All right, then, what is your recollection in the matter?

A. I don't know. I'm trying to answer as best I can, but I simply don't remember some of the details that happened eight years ago.

Q. All right. And, you can't remember whether cash was paid on the earlier transfers of the surface rights to McDonald Island Farms?

A. No, I don't.

Q. Now, about this transfer from McDonald Island Farms to Weyl-Zuckerman of the Henning gas rights, can you tell me the exact date upon which it was determined that that would be done?

A. No.

Q. Do you know whether the decision was reached by December 27th of 1946—Let's say December 21st of 1946? A. I don't know.

Q. You don't know? Do you know whether the deed was [97] executed before January 10th of 1947?

A. The deed from McDonald to Weyl-Zuckerman and Company?

Q. Yes.

(Testimony of John Zuckerman.)

A. I think it was, but I couldn't swear to it.

Mr. Nyquist: Do you have that deed with you?

Mr. Livingston: Yes.

Mr. Nyquist: I have here a deed which Petitioner's counsel has just handed me which appears to be the deed we are discussing from McDonald Island Farms to Weyl-Zuckerman and Company and I note thereon that it is recorded at the request of McDonald Island Farms, Ltd. on January 10th, 1947, at twenty-five minutes past 1:00 o'clock p.m.

May it be stipulated that that was the date on which it was recorded?

Mr. Livingston: Yes.

Mr. Nyquist: And I further note that the deed states on its face that it has been executed on the 21st day of December of 1946 and that it is signed by you.

Q. (By Mr. Nyquist): Can you tell me whether that deed—can you tell me, definitely, whether you have any recollection whether that deed was executed, actually executed on the date it bears or on December 10th, 1947—or rather, January 10th, 1947? [98] A. I couldn't tell.

Q. You couldn't tell? A. No.

Mr. Nyquist: Your Honor, may we have a recess at this time so we can get the book entries straightened out and that will finish up with this witness I believe.

The Court: We will take a short recess.

(A short recess was taken.)

Mr. Nyquist: Without taking the time of this

(Testimony of John Zuckerman.)

witness to identify them, I wish to offer the documents which the Petitioner has produced as Respondent's Exhibit next in order. I offer a group of documents consisting of a ledger sheet, a copy of a deed——

Mr. Livingston: Was that ledger sheet—have you finished with that?

Mr. Nyquist: Yes.

Mr. Livingston: Describe them a little more completely for the record.

Mr. Nyquist: I am going to describe them as relating to this particular piece of property.

Mr. Livingston: Thank you.

Mr. Nyquist: A ledger sheet and a loose leaf journal entry. It is a piece of paper which contains a journal entry showing a transfer of the Henning Tract to McDonald Island Farms and there is stapled to that a deed, [99] a copy of a deed, which apparently was kept there by the taxpayers for the purpose of identifying the sale to which this related, not part of a book entry but it apparently is for identification purposes.

Mr. Livingston: What is the date of the deed?

Mr. Nyquist: The date of the deed is June 27th, 1946. The date of the journal entry is June 27th, 1946, and the ledger sheet is a ledger sheet with respect to the Henning Tract and shows thereon a value at which it was carried on the Petitioner's books and the transaction relating to the sale.

The Court: This proposed exhibit consists of three——

(Testimony of John Zuckerman.)

Mr. Nyquist: Consists of three pieces of paper.

The Court: It consists of three pieces of paper.

Mr. Livingston: No objection.

The Court: Admitted.

The Clerk: Exhibit C.

Mr. Livingston: I understand this is offered as a part of the Respondent's case?

The Court: Respondent's Exhibit.

Mr. Nyquist: As Respondent's exhibit to show how Petitioner treated this on Petitioner's books. I don't think counsel can minimize the effect of the evidence by his equivocation. [100]

As Respondent's Exhibit next in order I have a ledger sheet from the books of McDonald Island Farms, Ltd., and a looseleaf journal entry; the journal entry showing the purchase—the purported purchase of the same land on June 27th, 1946, and the ledger sheet showing how it was carried on the ledger of McDonald Island Farms, Ltd.

Mr. Livingston: No objection.

The Court: Admitted.

The Clerk: Exhibit D.

(The deed, journal entry and ledger sheet referred to were received in evidence as Respondent's Exhibit No. C.)

(The ledger sheet and journal entry referred to were received in evidence as Respondent's Exhibit No. D.)

Mr. Livingston: Am I correct, Exhibit C are records of Weyl-Zuckerman and Company and D of McDonald Island Farms?

(Testimony of John Zuckerman.)

Mr. Nyquist: That is correct.

Q. (By Mr. Nyquist): Mr. Zuckerman, do you know the value at which the Henning Tract was carried on the books of Weyl-Zuckerman?

A. No.

Q. I show you Exhibit C, the ledger sheet, the first line of which under the date of January 15th, 1936, states, 2707 acres at $812,100, and it has been stipulated this is the ledger sheet with respect to the Henning Tract. [101]

Mr. Livingston: No, no, I haven't stipulated to that.

Mr. Nyquist: You haven't objected to the Exhibit which was introduced as such.

Mr. Livingston: No objection to the Exhibit, there was no stipulation to it.

Q. (By Mr. Nyquist): This is the ledger sheet with respect to the Henning Tract. Do you know the value at which—which was placed upon this land for the purpose of the sale to McDonald Island Farms? A. Its cost value of 338,000.

Q. 338,000? A. Correct.

Q. How was that value arrived at?

A. That was the cost.

Q. That was the cost? A. Right.

Q. To Weyl-Zuckerman?

A. As I understand it, yes.

Q. This eight thousand, or rather, $812,100 was not the cost? A. No.

Mr. Livingston: Just a moment. Well, no objection, it has been answered. Let it go. [102]

(Testimony of John Zuckerman.)

Q. (By Mr. Nyquist): That was an appraised value that was put on it at some later date?

Mr. Livingston: Object. The witness has not identified the documents. The witness cannot be cross-examined on the basis of documents which were not produced on direct examination. These documents are not prepared by the witness and therefore he is not responsible for them and I don't think it is proper cross-examination to ask him concerning the contents of documents that have not been identified by him. There is an explanation. We have got the man who kept the books. He is here and available for this interrogation and I intend to ask him those questions.

The Court: I think this is proper cross-examination.

Q. (By Mr. Nyquist): I am asking you about this $812,100 figure. You say that was not the cost of the land? A. No.

Q. Was that an appraised value that was put on the land at some date?

Mr. Livingston: I wish to examine voir dire. May I, your Honor.

The Court: I think it is appropriate at this time for counsel to pursue this with the witness.

Mr. Nyquist: Your, Honor, this is not a third [103] party witness, this is—this witness was, during this period the manager and I believe still is the manager—no, the corporation is dissolved, but he is here as a party in interest, in effect, and he has purported, on direct examination——

(Testimony of John Zuckerman.)

The Court: You may continue.

Mr. Livingston: May I make one suggestion, your Honor? Of all the things he said he did for McDonald, that is one thing he didn't include, and that is keeping its books. Now, this is a bookkeeping transaction, a bookkeeping entry.

Mr. Nyquist: That is objected to as leading the witness.

The Court: You have been leading the witness altogether too much, Mr. Livingston, and all the way through direct you have been putting words into his mouth and there has been practically no objection by the Government on that and I have sat by and let you do it, and I think it is wholly improper for you to try to put words in the witness's mouth when the witness is on cross-examination. This goes to the weight of the witness's testimony. You are going to get him on redirect. You can bring out all these matters.

Mr. Livingston: Has your Honor the remotest idea that anything I have said in the last five minutes is intended as a means of coaching Mr. Zuckerman as to what he is about [104] to testify to? Because, if you have, I wish you would dismiss it from your mind.

The Court: You are going to get the witness on redirect to the extent that these matters call for further clarification you can elicit that on redirect examination if you have any question as to any specific question you may make the objection. Now, apparently there are—this property was carried on

(Testimony of John Zuckerman.)

the books at figures that vary sharply from another figure that was used in this transaction. Now, it is wholly proper to inquire of this witness who has played a dominant role in the affairs of this enterprise or these enterprises for an explanation. Now, if it turns out that he can't give any explanation that is that, but it certainly is appropriate to make the inquiry.

Mr. Livingston: I have a little difficulty in following one comment of the Court. You say this property is carried on the books at a figure that is variant from some other figures that have been disclosed by the defendant. If that is true, it has escaped my attention.

The Court: Well, we have got two figures here. We have got a figure in the amount of some 338,375.

Mr. Livingston: That is the cost.

The Court: And then we—what was the other one? Then we have another figure in the amount of $810,000.

Mr. Livingston: That is the first time the figure [105] has appeared and it has come from a bookkeeping record.

The Court: Well, the witness may be interrogated about those two figures and asked to explain the difference between them. If he can't explain, that is that, but if he can this is cross-examination and counsel is entitled to interrogate him with a fair degree of latitude that would probe into the apparent discrepancy between those two figures and where they came from.

(Testimony of John Zuckerman.)

Mr. Nyquist: Can you find that question or shall I rephrase it, Mr. Reporter?

(Question read by the reporter.)

Mr. Nyquist: I will rephrase that question.

Q. (By Mr. Nyquist): Can you tell us what that $812,100 figure represents? A. No.

Q. How do you know it doesn't represent the cost, then?

A. Because I know the cost of three hundred and thirty-eight——

Q. How do you know that?

A. Well, I was—I just know it is the cost.

Q. How do you know, is my question? What was the source of your information? It obviously wasn't this book page.

A. I apparently satisfied myself as to that somewhere in the course of my business. [106]

Q. I see, and you have remembered it for how many years? A. Oh, about 20.

Q. About 20 years you have remembered that the cost of that property—I see.

When did the Weyl-Zuckerman acquire that property? A. Oh, around 1930.

Q. Around 1930? And were you in the business around 1930? A. I came in in 1932.

Q. In 1932? You weren't there at the time it was acquired? A. No.

Q. Where did you get your information as to cost?

A. I think at various times I asked our auditor, Mr. Von Husen, our treasurer.

(Testimony of John Zuckerman.)

Q. Then you statement, your testimony as to the cost of the property is on the basis of statements made to you by some other party, is that correct?

A. Yes.

Q. Is that true of other parts of your testimony?

Mr. Livingston: Object, too general.

Mr. Nyquist: I think it is very specific, your Honor.

Mr. Livingston: "Other parts", what parts?

Mr. Nyquist: Any parts. [107]

Q. (By Mr. Nyquist): Is it true of any other part of your testimony?

Mr. Livingston: It is still too general, your Honor. It is not a specific question at all.

The Court: I will let the question stand and if the answer is in the affirmative it should be followed up with further questions pinpointing it.

The Witness: What was the question?

Q. (By Mr. Nyquist): Were any other parts of your testimony here based upon statements made to you by others?

A. Well, I testified that somewhere or other Mr. Schroeder made an offer of $500,000. That would be a statement made to me by someone.

Q. No, you there, you heard that.

A. Anything that I said I was present at. Certainly it wasn't because somebody else told me that.

Q. You were present, that is not the type of inquiry——

A. I don't think I testified to anything that I wasn't present.

(Testimony of John Zuckerman.)

Q. You stated that the cost basis was the sales price here?

A. I have had occasion at various times in our business to ask the proper person in our business from whom I was ascertaining that information what the cost was and he told me [108] this figure of three hundred and thirty-some thousand dollars, but when it was I couldn't tell you.

Q. You were manager of Weyl-Zuckerman and Company on the date of that transaction, were you not? A. Yes.

Q. Who fixed that figure of $338,375 in which the 2700 acres were sold?

A. The Board of Directors.

Q. The Board of Directors? Who suggested that figure? A. I don't know.

Q. You don't know where that figure came from?

Mr. Livingston: Well, I don't understand that question. Maybe the witness does.

A. I don't know who suggested it. I know where it came from but it is the cost of the property.

Q. (By Mr. Nyquist): You know it is the cost because someone told you it is the cost, is that right?

A. Yes, yes.

The Court: Well, was that property acquired at a time before the gas was discovered?

The Witness: Sir, it was acquired before I was born, originally.

Mr. Nyquist: Now, your Honor, the stipulation shows that it was acquired back around about 1912

(Testimony of John Zuckerman.)

by this taxpayer, [109] I believe, and this gas was first discovered in the middle '30's.

Mr. Livingston: Were you alive in 1912?

The Witness: Two years old.

The Court: Well, the stipulation merely states that the Henning Tract was acquired by Weyl prior to 1932. It doesn't indicate when, but it was acquired at a time prior to the discovery of gas?

The Witness: Yes, sir.

Mr. Livingston: The fact is——

The Court: So that——

Mr. Livingston: Pardon me.

The Court: So that whatever the purchase price may have been, original purchase price on that tract, it would have been with respect to land as such rather than as to land with valuable mineral rights under it, the gas not having been discovered?

The Witness: No, but it did have the mineral rights at the time of the purchase.

The Court: Well, yes, whatever mineral rights were there with the purchase.

The Witness: Yes, sir.

The Court: Well, but the mineral, the gas not having been discovered, would not have figured in the purchase price? [110]

The Witness: I guess not.

The Court: So that upon the discovery of gas, the value of the property would then be greater than immediately prior to discovery of gas. Would that be a fair statement?

The Witness: Well, there are other—there are

(Testimony of John Zuckerman.)

other things that could come into it, but I suppose it would be ordinarily a fair statement, yes.

Q. (By Mr. Nyquist): Mr. Zuckerman, you were president of McDonald Island Farms during the years '46 and '47? A. Yes, sir.

Q. Is McDonald Island Farms now still an active corporation? A. No, sir.

Q. Were you its president up to the date of its dissolution? A. Yes.

Q. I show you the ledger sheet of McDonald Island Farms with respect to this same tract and call your attention to the fact that it shows acquisition of this land at the figure of $338,375 in June of 1946, and can you tell me what that March 31st entry, can you read the words in that, March 31st, 1931, entry there?

A. It looks like "UFD".

Q. UFD? Have you any idea what that abbreviation means? [111] A. No, sir.

Q. Who kept these books?

A. Mr. Von Husen.

Q. Mr. Von Husen, the——

A. The secretary of the company.

Q. That is the gentleman at the end of the table there (indicating)?

A. Yes, sir.

Q. That is, he was in charge of the books, who the actual bookkeeper was, it might have been somebody else? A. Yes.

Q. But he would be able to explain that?

A. I think so, yes.

(Testimony of John Zuckerman.)

Mr. Nyquist: I have no further questions of this witness, your Honor.

Mr. Livingston: Let me inquire of counsel, he brought up the existence of a corporation called M. Zuckerman, Inc. May I inquire whether counsel attaches any significance on the materiality of that corporation? If he does I will investigate it and explore it. If he doesn't—I think it is immaterial, but I want to be prepared.

Mr. Nyquist: It apparently had no active part to anything here. I don't attach any particular signifiance to it.

Mr. Livingston: Well, how about the fact Weyl-Zuckerman [112] and Company was dissolved in 1952, is that material to the issues in this case?

Mr. Nyquist: It doesn't appear to be material unless it affects the jurisdiction of the court in any respect. I haven't looked into that.

The Court: I suggest you make up your own mind whether these things are material or not, Mr. Livingston, and you carry on your examination in any light you form on it.

Mr. Livingston: All right. No redirect examination. Step down, Mr. Zuckerman.

I offer in evidence, if your Honor please, a deed dated June 27th, 1946, from Maurice Zuckerman, Herbert G. Zuckerman, Roscoe C. Zuckerman, as trustees to McDonald Island Farms, Ltd., undivided one-third interest in and to the property which I think we can agree is the—describes the surface rights of McDonald.

Mr. Nyquist: That accounts for the missing one-third?

Mr. Livingston: No, there is no missing one-third. At least I have never missed it.

Mr. Nyquist: No objection.

The Court: Admitted.

The Clerk: Exhibit 6.

(The deed above referred to was marked and received in evidence as Petitioner's Exhibit No. 6.) [113]

Mr. Livingston: I now offer in evidence the deed dated June 27th, 1946, from Weyl-Zuckerman and Company to McDonald Island Farms, Ltd. of an undivided one-third interest in and to the same property that is described in the deed just offered in evidence.

Mr. Nyquist: No objection, your Honor.

The Court: Admitted.

The Clerk: Exhibit 7.

(The deed above referred to was marked and received in evidence as Petitioner's Exhibit No. 7.)

Mr. Livingston: I offer in evidence the minutes of the meeting of the Board of Directors of McDonald Island Farms, December 21st, 1946, which embody the resolution for a declaration of dividend of the mineral rights under Henning Tract.

Mr. Nyquist: That is objected to, your Honor, on the ground it hasn't been properly identified.

Mr. Livingston: I submit the objection.

Mr. Nyquist: I said I object on the grounds it hasn't been properly identified, your Honor.

The Court: What do you say to that?

Mr. Livingston: Well, it is from the same book which——

Mr. Nyquist: I stipulated the earlier minutes but——

The Court: Not stipulating to this one? [114]

Mr. Livingston: The minutes are from the same book, is the same, it hasn't changed since the stipulation of counsel. If he wants to stipulate I could put in—I could put Mr. Von Husen on the stand.

The Court: His objection is technically accurate, and, of course, I will have to sustain the objection.

Mr. Livingston: Mr. Von Husen, will you take the stand please?

Whereupon,

JOHN VON HUSEN

called as a witness for and on behalf of the Petitioners, being first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Have a seat, sir, and state your name and address, please?

The Witness: My name is John Von Husen, V-o-n H-u-s-e-n, 1892 West Willow Street, Stockton, California.

Q. (By Mr. Livingston): On December 21, 1946, were you the secretary of McDonald Island Farms, Ltd.? A. Yes, sir.

Q. I show you a document or book entitled Mc-

(Testimony of John Von Husen.)

Donald Island Farms, Ltd. and ask you what that book is?

A. It is the minute book of the corporation of McDonald [115] Island Farms, Ltd.

Q. Were you present at the meeting that was held on December 21, 1946? A. Yes, sir.

Q. Will you state whether these minutes reflect the occurrences at that meeting? A. They do.

Q. And is that your signature?

A. Yes, sir.

Q. Your signature appended to the minutes?

A. Yes, sir.

Mr. Livingston: I now offer—any cross examination?

Cross Examination

Q. (By Mr. Nyquist): Mr. Von Husen, can you tell me when those minutes were prepared?

A. Right at the end of the meeting.

Q. You mean you sat down and typed these up at the end of the meeting?

A. Probably the next morning.

Q. And are you testifying that the meeting was held on this exact date, December 21, 1946?

A. Yes, sir.

Q. And that the parties who are listed here were present [116] on that exact date? A. Yes.

Mr. Nyquist: No further questions.

Mr. Livingston: I offer the minutes of December 21, 1946, in evidence.

Mr. Nyquist: No objection, your Honor.

The Court: They will be received.

(Testimony of John Von Husen.)

The Clerk: Exhibit 8.

(The minutes above referred to were marked and received in evidence as Petitioner's Exhibit No. 8.)

Mr. Livingston: Step down, please, Mr. Von Husen.

(Witness excused.)

Mr. Livingston: Now, in order to avoid unnecessary expansion of the record, I think we can agree as to their content, unless counsel wants them to go in as they stand.

The Court: Well, you submitted those two pages as an exhibit. Those two pages are now part of the record.

You give the book to the clerk, he will stamp it. If the parties wish, I will give you permission to withdraw the book and substitute a photostatic copy of the two pages.

Mr. Livingston: May I suggest this——

The Court: Or, if you desire, you may leave the entire book.

Mr. Livingston: Your Honor, if you recall, we agreed [117] the same book, you were talking about before, that the book might be left here, that the reporter was to transcribe this into his notes, certain paragraphs.

The Court: Those are not exhibits. It has been admitted as Exhibit 8.

Mr. Livingston: Would it be agreeable to have the exhibit copied into the record, or would you

prefer it—I am sorry if I am offending the Court. I assure you I am not doing it deliberately.

The Court: These two pages are now Exhibit 8. They have been received in evidence and all I can allow you to do is either to leave the book or I will let you withdraw the book, take a photostatic of those two pages or make any other kind of copy you wish, providing the Government is satisfied as to the accuracy of the two pages, and resubmit them.

Mr. Livingston: I desire to offer in evidence a deed dated December 21, 1946, and recorded on January 10, 1947, McDonald Island Farms, Ltd. to Weyl-Zuckerman and Company, Ltd. and after counsel has had an opportunity to examine it we may be able to agree that the property therein described is the mineral rights under Henning Tract.

Mr. Nyquist: I have no objection, but I am not stipulating as to the description. I haven't had a chance to study that out. It is the date you say the Henning Tract was transferred, but I didn't follow that description through. [118]

Mr. Livingston: Well, I will offer this in evidence, your Honor, please.

The Court: Admitted.

The Clerk: Exhibit 9.

(The deed referred to was marked and received in evidence as Petitioner's Exhibit No. 9.)

Mr. Livingston: I offer in evidence a deed dated June 27th, 1946, from Weyl-Zuckerman to McDonald Island Farms, Ltd.

Mr. Nyquist: No objection.

The Court: Admitted.

Mr. Livingston: Can we stipulate that the 2707 acres described in this deed comprise the so-called Henning Tract?

The Clerk: Exhibit 10.

Mr. Nyquist: No, I would rather you had someone identify that.

Mr. Livingston: All right.

All right, Mr. Zuckerman, will you step forward, please?

Whereupon,

JOHN ZUCKERMAN

recalled as a witness for and on behalf of the Petitioner, having been previously duly sworn, was further examined and testified as follows: [119]

Further Direct Examination

Q. (By Mr. Livingston): I show you Exhibit 10 and call the attention to the description of 2,707 acres and so forth. Will you tell me what property that is?

A. Henning Tract.

Q. I show you Exhibit 9 and call your attention to the description of mineral rights in the same 2,707 acres, I believe. Can you tell us what that property is?

A. Henning Tract.

Mr. Livingston: You may cross examine.

Mr. Nyquist: No questions.

Mr. Livingston: Mr. Von Husen, would you take the stand? You have been sworn.

Whereupon,

JOHN VON HUSEN

recalled as a witness for and on behalf of the Petitioner, having been previously duly sworn, was further examined and testified as follows:

Further Direct Examination

Mr. Livingston: May I have Exhibit C and D, please?

Q. (By Mr. Livingston): I call your attention to Exhibit C, the first page on that exhibit is—what kind of a sheet is that?

A. That is an entry sheet. [120]

Q. Entry sheet? Can you tell me in whose handwriting that is?

A. It is in my own handwriting.

Q. Will you explain the figures that appear on that page, please?

A. It records the transfer of the Henning Tract property to McDonald Island Farms by Weyl-Zuckerman and Company. This is the entry from the Weyl-Zuckerman and Company books.

Q. Under what date? A. June 27th, 1946.

Q. Go ahead, explain those figures.

A. The property was transferred by Weyl-Zuckerman and Company to McDonald Island Farms at the original cost of $125 per acre and the increment for which this land had been carried on the books was charged off to the surplus account of Weyl-Zuckerman and Company.

Q. And the cost was what?

A. The cost was $338,375.

(Testimony of John Von Husen.)

Q. And the increment was what?

A. The increment was $473,475.

Q. Now, will you explain to the court what that transaction is, involves the development of an increment on the books of the company with its inflection of surplus?

A. I referred to the old ledger and noticed that the land was bought originally in 1912 at $125 per acre for a total [121] of $338,375. In 1913, on February 28th, the ledger records an increment in land value of another $125 per acre or $338,375, and on October 30th, 1926, an additional increment in the value was recorded of $50 per acre, the total of $135,350.

The Court: Well, what is meant by these—this term "increment"?

The Witness: That is the notes I found on the ledger. I don't know just what was meant by that. I didn't make those entries myself.

Q. (By Mr. Livingston): Now, I show you a portion of Exhibit D, and I will ask you—which is headed Land, 1946, June 30th. Will you tell me in whose handwriting that was written?

A. That is Mr. Gibbons', who is the bookkeeper in our Stockton office.

Q. And is he under your supervision?

A. Yes, sir.

Q. Was he that time? A. Yes, sir.

Q. Are you familiar with the figures that appear on that page? A. Yes.

(Testimony of John Von Husen.)

Q. Will you tell the court what that page represents?

A. It records the acquisition of the Henning Tract [122] property by McDonald Island Farms in June of 1946, at $125 per acre or a total of $338,375.

Q. And what about the other figures?

A. The next entry is on December 21, 1946, covering a deed executed by McDonald Island Farms, Ltd. to Weyl-Zuckerman and Company, transferring mineral and gas rights on the Henning Tract property, which is a credit to this account.

Q. Now, there is a notation that was called to the attention of Mr. Zuckerman on cross-examination in the tax return, which, as I recall, involved the transfer of two-thirds of the surface rights of the McDonald Tract by the Weyl-Zuckerman and Company to McDonald Farms, Ltd. Do you recall that?

A. Yes, sir.

Q. Will you explain the circumstances under which that occurred?

A. It was about ten days or two weeks before the transfer of the surface rights on the McDonald Tract to McDonald Island Farms, Ltd. that Weyl-Zuckerman acquired from Zuckerman Potato Company their one-third interest in the surface rights of the McDonald Tract for which they paid cash at the time. There was no deed executed for this particular transfer as this property subsequently went to McDonald Island Farms, Ltd. and it was deeded directly by the [123] trustees of the Zuckerman Potato Company to McDonald Island Farms, Ltd.

(Testimony of John Von Husen.)

Q. Now, have you any records disclosing the trans—the details of these transactions insofar as purchase price and receipt of purchase price is concerned?

A. I know there is a ledger account which reflects the payment of——

Mr. Nyquist: Objection, your Honor, to any testimony as to what the contents of a ledger account——

Q. (By Mr. Livingston): Don't tell us what they contain, just tell us whether there are such ledger pages? A. Yes, sir.

Q. Are they in court here? A. No.

Q. Well, have you any records appertaining to the use of the funds—let's take, for example, the $720,000 that was borrowed from the Bank of America. Have you any records here disclosing the disposition of those funds?

A. The $720,000 which McDonald Island Farms obtained from the Bank of America was paid over to Weyl-Zuckerman and Company in payment for the Henning Tract of $338,375 of the two-thirds of the surface rights which they acquired from Weyl-Zuckerman and Company for a total of approximately $240,000 as well as for consideration for the improvements [124] and the equipment on Henning Tract, which accounted for these funds.

Q. Now, what was done with the payments received by Weyl-Zuckerman and Company from McDonald Island Farms, which you have just described?

(Testimony of John Von Husen.)

A. Well, Weyl-Zuckerman and Company repaid the Bank of America for the short term notes covering the acquisition of the McDonald stock from the Holly Sugar Corporation to the extent of $216,620. It also paid for the mineral right acquired from the Holly Sugar Corporation, one hundred and eighteen thousand odd dollars. It retired the outstanding bonds on the Henning property of approximately 146,000 and it also retired some long term notes to E. M. Weyl for $95,000 and to Helen Rosenfels for $66,000.

Q. What was that last figure?

A. 66,000, approximately, $66,000.

Q. What was done by the purchase price received from the Weyl-Zuckerman and Company from the Pacific Oil Company of $609,000?

A. That money was——

Q. Well, pardon me. Let me interrupt here for just a moment. You said that—go ahead, thank you.

A. What?

Q. Withdraw the interruption.

A. All 609,000, there were notes paid to the Bank of [125] America which had become due on December 31, 1946, and which were overdue at the time. There were $350,000 of such notes that Weyl-Zuckerman and Company owed to the bank and there was another hundred thousand dollars that Weyl-Zuckerman's subsidiary, the General Potato and Onion Distributors owed to the Bank of America, and there was $150,000 owed by the Zuckerman

(Testimony of John Von Husen.)

Potato Company. That accounted for $600,000 of that money.

Mr. Livingston: You may cross examine.

Cross Examination

Q. (By Mr. Nyquist): Getting back to this one-third interest in the McDonald surface rights which were held by Zuckerman Potato Company——

A. Yes.

Q. I wanted to be sure I understood your testimony on that. You say that a conveyance was made directly from Zuckerman Potato Company to McDonald Island Farms——

A. That is correct.

Q. ——Ltd.? A. That is correct.

Q. But it was taken in on the books of Weyl-Zuckerman and shown as a sale by Weyl-Zuckerman to—— A. That is correct.

Mr. Nyquist: I ask that this be marked for [126] identification.

The Clerk: Exhibit E for identification.

Mr. Nyquist: I show you Respondent's Exhibit E for identification and ask you if that is your signature at the bottom of that document?

A. Yes.

Q. Does this document consist—is this document a protest filed on behalf of Weyl-Zuckerman and Company with the Bureau of Internal Revenue in connection with this matter?

A. Yes, it is.

Mr. Nyquist: I offer this in evidence, your Honor.

(Testimony of John Von Husen.)

Mr. Livingston: No objection.

The Court: Be admitted.

The Clerk: Exhibit E.

(The protest above referred to was marked and received in evidence as Respondent's Exhibit No. E.)

Mr. Nyquist: No further questions, your Honor.

Mr. Livingston: That is Petitioner's case, your Honor.

(The deed referred to was marked and received in evidence as Petitioner's Exhibit No. 10.)

Mr. Nyquist: I have here a document which I would like to introduce as Respondent's next in order. I have submitted it to Mr. Livingston. You have a copy. It is merely [127] a computation of corporation income tax for the year 1946, assuming all items of gross income and deductions and credits, the same as on the Weyl-Zuckerman return, but excluding that amount of $230 and making the corresponding adjustment to the different received credit. It is for showing the amount of additional tax they paid in '46 in order to get what the Government contends is that attempted tax saving.

I believe he will stipulate to the accuracy of the computation.

Mr. Livingston: I will stipulate to the accuracy of the computation but I don't consider it proper material for an exhibit.

The Court: The exhibit will be admitted.

The Clerk: Exhibit F.

(The computation referred to was marked and received in evidence as Respondent's Exhibit No. F.)

Mr. Nyquist: You have rested your case, Mr. Livingston?

Mr. Livingston: Yes.

Mr. Nyquist: Mr. Schroeder, will you take the stand, please?

Whereupon,

GEORGE SCHROEDER

was called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified [128] as follows:

Direct Examination

The Clerk: Will you have a seat, sir, and state your name and address, please?

The Witness: George Schroeder, Standard Oil Company of California, 225 Bush Street, San Francisco.

Q. (By Mr. Nyquist): Please state very briefly the general nature of the Standard Oil Company?

A. Well, it is in the business of producing and refining, distributing oil, gas and other hydrocarbon substances in California and other states.

Q. And are you acquainted with the Pacific Oil Company? A. Yes, I am.

Q. Will you explain its relationship to Standard Oil Company?

(Testimony of George Schroeder.)

A. It is a 100% subsidiary of Standard Oil of California.

Q. You stated you are also employed by Standard. Are you also employed by Pacific Oil?

A. I think you can say I am. It is a hundred per cent subsidiary and we do work for the subsidiaries as well as the parent corporation.

Q. You brought certain documents with you in response to a subpoena?

A. I have them here. [129]

Q. One of these documents is the original of the deed, a copy of which is already in evidence, one of Petitioner's exhibits. That is a deed dated November 18th, 1935—excuse me, dated January 20, 1947, and recorded January 23, 1947, from Weyl-Zuckerman to Pacific Oil Company. I am not sure of the number, but Petitioner has put a copy of this in evidence. I would like to put a copy, a photostatic copy of the original in evidence as Respondent's Exhibit next in order.

Mr. Livingston: No objection.

The Court: It will be admitted. I would like counsel to tell me why we need two copies of the same exhibit.

Mr. Nyquist: Well, the witness John Zuckerman was unable to recall whether the deed from McDonald Island Farms to Weyl-Zuckerman which was recorded on January 10th, 1947, or whether it was executed on the date that it bears, December 21, 1946.

(Testimony of George Schroeder.)

Mr. Livingston: I didn't quite follow that. Will you read that to me please?

Mr. Nyquist: I say the witness John Zuckerman was unable to recall when he was questioned, he said he was unable to recall or testify whether the deed from McDonald Island Farms to Weyl-Zuckerman, which bears the date of December 21, 1946, was recorded January 10th, 1947. He was unable to recall whether that deed was executed on the date that it bears or on [130] the date that it was filed and——

Mr. Livingston: Well, I don't see. Maybe I don't understand.

Mr. Nyquist: Can I finish my sentence? I will tell you what I am driving at. This deed, which was executed by the taxpayer, Exhibit G, contains in it a recital: "Whereas by deed, executed by McDonald on December 21, 1946 and recorded on January 10th, 1947 * * *" and so forth.

Now, that statement appears both in the copy I am introducing and the copy you are introducing, but the copy I am introducing, which is a copy of the original, shows that a date, January, 1947, was typed in and struck out and January 21, 1946, was substituted.

Mr. Livingston: The deed he speaks of was acknowledged on December 21, 1946.

The Court: What is the corresponding exhibit number of the other one?

The Clerk: Exhibit G.

(Testimony of George Schroeder.)

The Court: In other words, Exhibit G and Exhibit 5 purportedly relate to the same matter?

Mr. Nyquist: Exhibit G is a copy of the original deed in the possession of Standard Oil, Exhibit 5 is a copy of the records of the County Recorder. I believe that is correct, is it?

Mr. Livingston: I think so. [131]

The Court: In other words Exhibit 5 is a copy of a copy, whereas Exhibit G is the original—is a copy of the original?

Mr. Nyquist: Photostat of the original and the original is here in case anyone cares to inspect it.

The Court: I see. Thank you very much.

(The photostat referred to was marked and received in evidence as Respondent's Exhibit No. G.)

Q. (By Mr. Nyquist): Mr. Schroeder, will you describe the situation that existed, or the business relationship that existed between Weyl-Zuckerman and this Standard Oil Company at the beginning of 1946? A. The business relationship?

Q. Yes.

A. Well, we were—Standard Oil Company of California was the lessee of——

Q. Let me interrupt a moment. I am not sure that is clear in the record just what the nature of your employment with Standard Oil Company is. I think that should be clarified first.

A. I am manager of the contract division of the producing department of Standard Oil Company of California and a part of my work in the company

(Testimony of George Schroeder.)

through the years has been the administration of contracts and negotiation of leases and [132] purchase of properties that are involved on and in gas lands.

Q. Did you do the negotiating with respect to the dealings with these—with the Weyl-Zuckerman Company?

A. I did the negotiating; yes, sir.

Q. What was the business relationship that existed at the beginning of 1946?

A. At the beginning of 1946, the Standard Oil Company of California was the—was the lessee of Weyl-Zuckerman and the McDonald Island Farms. I have here some papers; I would like to look at these papers to get those correct names of the corporations if that is of significance. One was Weyl-Zuckerman and Company and the other one—well, I guess you know what it is, it is McDonald Island Farms Company, I guess it is.

Q. I think I can speed this up a little by a leading question. There has been testimony on direct examination—rather there has been testimony earlier in this case about some friction between Standard Oil Company and Weyl-Zuckerman and around that date, and I am wondering if you would explain the nature of that friction?

A. Well, I have these memos here with these dates and—are the dates significant here?

Q. Yes, the dates are significant.

A. Or do you want me to just state——

Q. The dates are significant. [133]

(Testimony of George Schroeder.)

A. Well, from these memos——

Q. If you need to look to refresh your recollection, yes.

A. Well, this is a memo, memorandum dated December the 13th, 1946.

Q. Pardon me. A. Yes.

Mr. Nyquist: Let me mark these memoranda for identification at this time.

You have a photostat of each of these, I believe, and I won't have to take your originals.

I will ask you to mark as exhibits next in order for identification, these four documents. Do you want to see these?

Mr. Livingston: As long as they are only for identification——

The Clerk: Exhibits H, I, J and K for identification.

(The documents above referred to were marked for identification as Respondent's Exhibits Nos. H, I, J and K.)

Q. (By Mr. Nyquist): I ask you, Mr. Schroeder, were these memoranda made by you in the course of your business at about the time of the transactions between yourself and—between Standard Oil Company and Weyl-Zuckerman? [134]

A. They were.

Q. And at the time did you know the statements contained therein to be correct?

A. Oh, yes.

Mr. Nyquist: I shall offer these in evidence as Respondent's next in order.

(Testimony of George Schroeder.)

Mr. Livingston: Well, I must object, your Honor. In the first place on their face they demonstrate they are not contemporaneous memoranda. In the second place, it is not permissible to offer in evidence memoranda of any kind. The proper procedure is that if there is contemporaneous memoranda, as the witness needs by such contemporaneous memoranda to refresh his recollection, he may use that memoranda for the purpose of so doing it, but the memoranda itself is not in evidence, but there are two objections to the offer counsel has made.

Mr. Nyquist: He has testified that these are memoranda made in the regular course of his business at the time.

Mr. Livingston: I don't think so.

Mr. Nyquist: And for that reason I have offered them. However, I will take—it will take a little longer to go through them with the witness. I will be glad to go at them that way if it is desirable.

Mr. Livingston: May I ask the witness a question [135] on voir dire?

Voir Dire Examination

Q. (By Mr. Livingston): Mr. Schroeder, this memoranda was prepared on December 13th, 1946, was it not? A. Yes, sir.

Q. And it purports——

The Court: You are referring to one of these memoranda, Exhibit H, for identification?

Mr. Livingston: The one that is headed December 13th, 1946, San Francisco, December 13, 1946.

(Testimony of George Schroeder.)

Q. (By Mr. Livingston): That was prepared on the date that appears there? A. Yes.

Q. And this memoranda was not prepared at or about the time of this conversation that is related in the memorandum which occurred in November, 1945, it was prepared some year and thirteen months afterwards, is that correct?

A. That is correct.

Direct Examination—(Resumed)

Q. (By Mr. Nyquist): At the time you prepared the memorandum did you know the facts stated therein to be true?

A. Yes, I believe everything stated here is a true statement. I made it with that intention. [136]

Mr. Nyquist: If your Honor desires, I will take this witness through the things one at a time.

The Court: I am going to adjourn at this time. We will reconvene at 10:00 o'clock tomorrow morning.

(Whereupon, at 4:35 p.m. a recess was taken until 10:00 o'clock a.m., Thursday, March 18, 1954.) [137]

The Clerk: Docket No. 43,504, Weyl-Zuckerman and Company.

Mr. Nyquist: Any questions, your Honor? I will ask Mr. Schroeder to take the stand again.

Whereupon, George Schroeder resumed his testimony as follows:

Mr. Livingston: In line with your discussion of yesterday afternoon, if the Court please, I am will-

(Testimony of George Schroeder.)

ing that Mr. Schroeder may use this memorandum of December 13, 1946, but I think it is necessary that an obvious stenographic error——

The Court: I don't know what you mean. You said "is using it." What do you mean by "using it"?

Mr. Livingston: Well, he may have it before him and testify from it. It is my impression that Mr. Nyquist desires to follow that course. If I am in error then I will not press the proposal.

Mr. Nyquist: Your Honor, I believe Mr. Schroeder probably can testify from recollection on most of this but, if necessary, we will ask him to refresh his recollection from the documents.

The Court: He may do so.

Mr. Nyquist: All right. [139]

Q. (By Mr. Nyquist): Mr. Schroeder, will you——

Mr. Livingston: My suggestion is withdrawn. Mr. Nyquist will proceed on his own matter.

Q. (By Mr. Nyquist): Mr. Schroeder, will you explain the business relationship that existed between the Standard Oil Company, Weyl-Zuckerman and Company, and McDonald Island Farms, Ltd. in the latter part of 1945 and the early part of 1946, briefly?

A. The Standard Oil Company had leases that were—that we were the lessee and these companies you name, McDonald Island Farms and Weyl-Zuckerman and Company were the lessors. The lands covered by the leases were over in what we call the McDonald Island gas field and the mainte-

(Testimony of George Schroeder.)

nance of that lessor-lessee relation is something that more or less fell to me. There were times when the landowners would come in and make inquiry, ask—complain about this or that, particularly the amount of royalty that was allocated to these pieces of property as compared to the amount allocated to other properties in the field and we used to confer quite a bit about that in an effort to see that the correct amount of gas produced from the different properties was the fair and equitable share of each of the lessors.

Q. Well, how would you describe the relationship that existed with respect to these particular lessors, that is, in [140] the sense of whether it was a smooth running relationship or whether there was friction?

A. Well, we had many complaints from the Zuckermans.

Q. Will you tell us, with as great a degree of precision as you can, as to dates, the course of the early offers to buy or to sell with respect to the gas rights that were ultimately conveyed to the Standard Oil Company subsidiary in the early part of 1947?

Mr. Livingston: Objection. The question is too general. The proper course is to interrogate the witness as to a specific conversation.

Mr. Nyquist: Well, I will be very glad to tell the witness the specific dates and places of the conversation, if it is satisfactory to Mr. Livingston. I was trying not to lead the witness, your Honor.

(Testimony of George Schroeder.)

Mr. Livingston: Thank you.

Q. (By Mr. Nyquist): Was there a conversation in November, 1945, with respect to a possible sale to Standard Oil Company of gas rights on McDonald Island? A. Yes, sir.

Q. Can you tell us the general—can you tell us what was said on——

A. Oh, I don't think so. I don't remember particularly who said what and how and when, but I did make this note here [141] and I do know that I offered the Zuckermans 500,000 for those—for their interest in those leases. Now, whether this could have covered just the gas rights initially, whether we were talking about all of the rights including surface and all those things like that, I couldn't tell you, but I did make this note and I do know that I had the conversation as I indicated in this memorandum and he did offer them $500,000.

Q. Was that offer accepted? A. It was not.

Q. What was the next step in the negotiations early in July of nineteen forty——

Mr. Livingston: Objection. Calls for the conclusion of the witness. Proper question is to inquire concerning a specific conversation.

Q. (By Mr. Nyquist): Were there further negotiations in July of 1946?

Mr. Livingston: Objection. Proper question should be: was there——

The Court: The witness may answer.

A. Will you ask that again, please?

(Testimony of George Schroeder.)

Q. (By Mr. Nyquist): Were there further negotiations in July of 1946? A. Yes.

Q. Will you tell us about those negotiations?

A. At that time Maurice Zuckerman called at the office and offered to sell these properties and again I can't be specific as to whether it included this or that or what, but generally the gas rights in there which were the subject of our concern.

The Court: By "the gas rights" do you mean the gas rights underlying the entire island?

The Witness: Yes, sir. He offered that for $875,000 but before the meeting was over he indicated to me that if we would go along that he would be willing to cut that down to $820,000. I had the feeling that he wanted us to kind of nominate a figure there of that order.

Q. (By Mr. Nyquist): Was John Zuckerman present at that conference?

A. I do not remember.

Q. You have no present recollection of whether John Zuckerman was present at that conference?

A. I don't recall that he was there. I don't believe—I would have to say I don't believe he was there; I don't remember that he was there.

Q. Could your recollection on that matter be refreshed by looking at the second paragraph of your memorandum of December 13th, 1946?

A. At that time John Zuckerman suggested that they would—is that the paragraph you mean?

Q. Yes. [143]

A. Well, that did not have to do with the dis-

(Testimony of George Schroeder.)

cussion in July. That had to do with the discussion in August.

Q. Oh, I see. I misunderstood. All right, was there a further discussion in August of 1946?

A. Yes, sir.

Q. Will you tell us the nature of that discussion?

A. At that time I—that was following discussions with our own people after the thing had been pushed around by our own group, and I told John Zuckerman at that time that we would not go for their proposal because it was he who indicated that —at the time—that they would probably then get ready to sue because of some of these differences of opinion that we had in respect to the allocation of production to these properties and the matter of drilling additional wells and things of that sort in connection with the administration of the lease.

Q. Did this statement by Mr. Zuckerman that he would probably get ready to sue have any effect upon your attitude toward further negotiations for the purchase of these gas rights?

Mr. Livingston: Objection. Calls for the conclusion of the witness.

Mr. Nyquist: Your Honor, I am making inquiry here as to his motives and attitude and how this particular fact affected his outlook on the transaction. This is exactly the [144] same thing that we were covering all day yesterday in Mr. John Zuckerman's direct testimony.

Mr. Livingston: I don't think so. I don't think the business purposes of the Weyl-Zuckerman Com-

(Testimony of George Schroeder.)

pany can be determined by the attitude of mind on the part of Standard Oil Company nor upon the part of this witness.

Mr. Nyquist: I might say the purpose, your Honor, is simply to show that the ultimate purchase was due to a certain extent, to a desire to eliminate a possible law suit. That is, the threat to sue was a factor in the negotiations.

The Court: Well, I don't see there is any real difference between the parties on that. It seems to me that exactly was what Mr. Livingston was trying to establish through Mr. Zuckerman's testimony yesterday. What is the quibbling between you about?

Mr. Livingston: I don't put it in the same way, that is all. The implications that I find in the testimony are that no one knuckled down to the other because of a prospective law suit. On the contrary, that law suit was, in preparation and that by means of a sale they avoided it. Standard Oil Company, I don't think, was afraid of Weyl-Zuckerman's law suits. I may be wrong, but I don't think it makes any difference. I think it is immaterial whether they were afraid or not. The facts are there and it is for the court to determine the consequences of the fact.

The Court: Gentlemen, the difference between you escapes me.

Mr. Livingston: It may be. However, the difference, if it does exist, in my own mind, it may be utterly immaterial so therefore I don't think the question is proper.

(Testimony of George Schroeder.)

The Court: If it is immaterial it will go to the weight. However, out of an abundance of caution I will allow the witness to answer.

Will you read it back, Mr. Reporter?

(The question was read by the reporter.)

A. Well, I don't recall that it had any effect upon my attitude, if you mean mine. I don't recall that it had any effect upon mine.

Q. (By Mr. Nyquist): Was it an element that was considered and given some consideration in determining whether the ultimate purchase should be made?

Mr. Livingston: Same objection, and further objection that counsel is cross examining his own witness.

The Witness: Will you——

The Court: The witness may answer.

The Witness: Will you read it back again, please? I am sorry.

(The question was read by the reporter.)

A. Yes, sir. [146]

Q. (By Mr. Nyquist): Will you explain that statement?

Mr. Livingston: Same objection; calls for the conclusion and explanations not proper on direct examination.

The Court: The witness may answer.

The Witness: Would you read it to me, please?

(The question was read by the reporter.)

A. All during these negotiations we were concerned with the administration of this rather com-

(Testimony of George Schroeder.)

plicated, so-called, rateable taking plan matter of apportioning the gas company's demand for deliveries between the various properties in the McDonald Island gas field that we were operating under lease and when one landowner comes in and complains about his share and wants it to be increased, we are naturally concerned with it. We still want to be able to apportion the entire production properly between all of the properties, and there was also the matter of the drilling of a well in there, and I believe after one time we indicated that we might probably drill that extra well, and yet those things always bothered us. They were always there, and they had some bearing, maybe, in coming up with the final dollars that we ultimately agreed to pay for this thing. It was part of the whole picture.

The Court: Well, of course, Mr. Nyquist, what may have been the secret understanding or secret intentions of Standard Oil or its subsidiaries can have no bearing upon the [147] outcome of this case and to that extent Mr. Livingston's objections—he is right in his objections and I am not going to give any weight to any undisclosed intentions of Standard or its subsidiaries in this matter. The important thing, it seems to me in connection with this case, is to what extent Standard's thoughts, negotiations, and similar matters were made known to the Petitioner or its representatives or might have been ascertainable or discerned by such representatives and, to that extent, this testimony may

(Testimony of George Schroeder.)

be relevant but it is relevant only to the extent that, the purpose of Standard was either explicitly made known to Zuckerman or its representatives or to the extent that it was reasonably inferred that it was readily ascertainable by them.

Mr. Nyquist: It was merely introduced in showing it had some effect in facilitating a sale here. I don't expect I can get Petitioner to say it was intended for that purpose, but I merely want to show it had that effect.

The Court: I just want the record to be clear that I am admitting his testimony for only the limited purpose.

Q. (By Mr. Nyquist): Mr. Schroeder, was there a further conversation on December 12th, 1946, with respect to the McDonald Island gas rights?

A. Yes, sir.

Q. Will you tell us the substance of that conversation? [148]

A. On that day Mr. John Zuckerman came into the office and indicated that they did not like to sue and that they would like to get back into the picture again on the basis of the sale of their interest and we mentioned the $500,000. I think John Zuckerman mentioned that as being too low and mentioned it ought to be 30% more, namely $650,000, and I believe I indicated that because of the payment of royalty between December 1st, 1945, and the date of that conversation, practically most of that year, that whatever the value should have been on the thing it would have to be reduced by the

(Testimony of George Schroeder.)

value of the production taken out in the interim and the net result of that was that John Zuckerman indicated willingness to sell the McDonald Island interest. According to my memorandum—I don't remember this in the discussion with John—but according to the memorandum that I wrote at that time he indicated that there would be willingness on their part to sell the McDonald interest right then at that time in December, 1946, for its proportionate share of this $650,000 minus royalty and that we could have an option to buy the Weyl-Zuckerman parcel at some subsequent time for the same—for a proper apportionment of the same amount of dollars and those conversations, with respect to the sale of those interests, had to do with the gas rights and a certain reservation in the Zuckermans with respect to one-eighth oil royalty and I believe, initially at that time, [149] one-eighth gas royalty in certain zones that were not then being produced or certain portions of the property that were not then being produced.

Q. Mr. Schroeder, leaving now the subject of the negotiations with respect to sales price and turning to the matter of form of the ultimate conveyances, was there a conference on or about December 23rd, 1946, in this connection? A. Yes, sir.

Q. Were any documents produced at that conference? A. Yes, sir.

Q. Could you tell us what those documents were?

A. I don't recall them particularly, but they were documents.

(Testimony of George Schroeder.)

Mr. Livingston: Pardon me just a moment. I believe the witness is now referring to something in writing and I object on the ground that this form of testimony is not admissible. The writing is the best evidence.

Mr. Nyquist: You said—well, I will, then, offer the writing in evidence if it is agreeable with Mr. Livingston.

The Court: You object to the writing itself being offered?

Mr. Livingston: No, no. I haven't seen it yet. I don't know what particular writing they have in mind. (Mr. Nyquist handed Mr. Livingston a document.) That is not a writing. Counsel submits to me a memorandum. [150]

Mr. Nyquist: That is the——

Mr. Livingston: May I complete my statement? That is a memorandum dated September 24th, 1946, which is signed by the witness. As I understand the question, it asks the witness to tell him, or rather, to state to the court the contents of a document that existed on December 23rd, 1946.

Mr. Nyquist: Your Honor, I merely asked for a description of what documents were prepared. I did not request the contents of any documents.

Mr. Livingston: I misunderstood the question.

Mr. Nyquist: At least I so intend the question. I will withdraw the question and rephrase it.

Q. (By Mr. Nyquist): Were any drafts of deeds prepared and submitted at that conference?

A. It is my recollection that I went over there

(Testimony of George Schroeder.)

with Mr. Capocelli of Pillsbury, Madison, and Sutro and that we presented it to Mr. Livingston and Mr. Maurice Zuckerman and Mr. John Zuckerman our ideas of how papers might be drawn to cover the grant from the land owners to the Pacific Oil Company.

Q. Was one of those a draft of deed with respect to the Henning property?

Mr. Livingston: I object. I object on the ground [151] the deed is the best evidence of what it was. The question is improper on that ground.

Mr. Nyquist: Your Honor, I am not asking for the contents of the document. I am merely describing the document: was there a deed with respect to the Henning Tract?

Mr. Livingston: It tells us what was in it. I think that is the danger of asking for oral testimony as to the content of the document because the witness, his recollection may be at fault, his interpretation of the document may be erroneous. There is a historic rule—a historic basis for that rule.

The Court: In my judgment, Mr. Livingston, you are now engaging in obstructive tactics.

Mr. Livingston: Your Honor, please—go ahead. Now, I think——

The Court: There was property involved here that was in the hands of two different corporations——

Mr. Livingston: I think your Honor is—pardon me.

The Court: ——and this is a substance versus

(Testimony of George Schroeder.)

form case and the question ultimately to be decided is whether what appeared to be the facts are the true facts. Now, we have a transaction that was ultimately consummated in one matter. There is being presented testimony as to the nature [152] of that transaction before its ultimate consummation in an intermediate stage. I think the witness is competent to testify as to what form the transaction was to take or what form it was proposed to take prior to the conversion of that form into some different form that was ultimately used.

Mr. Livingston: Your Honor, I——

The Court: I remind you again, Mr. Livingston, as I think I did informally earlier in the trial, perhaps it was at a discussion at the bench, that rule 31 of the Rules of this Court contemplate that the parties will stipulate facts that are not fairly in dispute and it seems to me that the facts that relate to the prior documents that are here under discussion should be facts that should not be in dispute at all between the parties, and it seems to me that what you are doing is merely making it difficult to establish matters with respect to which there should be no dispute whatever between you.

I am going to call a recess at this point and I am going to ask counsel to get together with each other and see if they can't undertake to establish an agreement between themselves as to what those prior documents were.

Mr. Livingston: Before the recess, may I say something for the record?

(Testimony of George Schroeder.)

In the first place, I wish to call attention to the fact that if I had prepared in ample time a stipulation of [153] facts it would not have been accepted by Mr. Nyquist and the demonstration of that is that the stipulation of facts which I submitted to him last Monday was rejected substantially and the only stipulation that he was willing to give me is one consisting of approximately two pages, as I recall. I think that demonstrates that if there was any delay on my part in that respect it was delay without any consequence. It would have been an idle act for me to have asked him to stipulate to a lot more things and it was only the insistence on the part of your Honor that the parties get together that enabled us to get the stipulation prepared during the recess, as far as it went.

The Court: I was calling your attention to the rules of the court, and Rule 31 of this court contemplates that the parties will agree upon facts that are not fairly in dispute between them and I am now going to call a recess and I am going to call upon the counsel to get together with each other to attempt to establish and present to the court the facts in relation to these—to this transaction as it was originally formulated, a matter of which should not be in dispute at all between them.

Mr. Livingston: Yes, but my difficulty, if I may complete my statement, your Honor, is this:

Your Honor has the idea in your mind that I am engaging in obstructive tactics. You have given me no opportunity to [154] justify my position. As it

(Testimony of George Schroeder.)

now stands, your Honor has this viewpoint which, of course, must react, at least unfavorably toward me as a member before this bar, and I stand virtually convicted without having an opportunity to present my defense. That, whether or not that attitude of mind would be translated to the merits of this case, who can tell?

The Court: Well, I have no intention whatever of suggesting anything of that sort, Mr. Livingston.

Mr. Livingston: All right, let's assume, your Honor can divorce Livingston from Zuckerman or Weyl, at least my reputation is of sufficient value to me in this community so that when a judge undertakes to charge me with obstructive tactics I should have a chance to prove I am not guilty of the charge. After 45 years of practice in San Francisco such little reputation as I have been able to attain in the community should not be shattered.

The Court: Well, there was no intention to make any such suggestion as that, Mr. Livingston. It was the course that the trial was taking this morning that was making it extremely difficult to establish facts which really should not have been in dispute at all between the parties——

Mr. Livingston: But my—pardon me.

The Court: ——and I suggest that an effort be made to arrive at——

Mr. Nyquist: Your Honor—— [155]

The Court: ——an agreement between the parties as to those facts.

Mr. Livingston: I assure you—Pardon me.

(Testimony of George Schroeder.)

The Court: I think you are undoubtedly magnifying the remark I made far beyond its import, and I assure you there was no intention at all to reflect upon you.

Mr. Livingston: I am delighted to hear that——

Mr. Nyquist: Your Honor——

Mr. Livingston: May I finish, please? I have one more thing I want to say. I say, I am delighted to hear that because ordinarily that is regarded as unethical practice in this community, and any lawyer who seeks to practice on an ethical plane will not do that.

Now, as far as agreeing, if counsel had said to me, "I would like to have the identity of these documents that were presented at this meeting of December 23rd, 1946, established," all he had to do was show them to me. My point is, how can we ask a witness on the stand to tell us about what document, what it looked like, what it contained, when the transaction of the incident that he undertakes to relate occurred some seven years ago?

The Court: Well, the essence of counsel's questions did not go, as I understand them, to the minutiae of these documents. A document can be described as a deed from A to B without getting into the details of the document, and I [156] gathered that was the sole import of these questions as to whether or not there were two deeds, one running from one grantor and another running from the second grantor, both to a common grantee, without getting into the details of the document at all.

(Testimony of George Schroeder.)

Now, I take it that was the sole import of the Government's questions. Is that right, Mr. Nyquist?

Mr. Nyquist: That is right, your Honor.

The Court: Now, can't the parties agree on that?

Mr. Livingston: I can't agree without seeing the documents, that is obvious. Apparently Mr. Nyquist, if it is a fact as your Honor suggests, that there were in existence at that time or submitted——

The Court: I don't know the facts at all. I am suggesting only that these are facts that should be known to both parties and if they are known to both parties they are facts that are not fairly in dispute. That is all I am saying.

Mr. Livingston: Well, I certainly cannot say at this time that I know the answer to that question because my recollection, although I sat in on these conferences, my memory is not so well developed that I can say what papers I saw at that time.

I know, because we have introduced them in evidence, the papers that were eventually signed. Now, if, as Mr. Nyquist suggests, there is an importance to be attached if this [157] were two deeds signed at that time we shouldn't depend on Mr. Schroeder's recollection as to whether there were two deeds or not. I think it is proper to have the papers here. That is all.

It may not be of any consequence, but if it is, I should not be placed in the position of having my case prejudiced by a possible failure of memory or misapprehension on the part of Mr. Schroeder concerning a seven-year old transaction. So, I would be

(Testimony of George Schroeder.)

glad to take advantage of the recess and see if we can find out what the documents were.

Mr. Nyquist: Your Honor, it is quite possible I could bring out the same point by a slightly different question without reference to the documents, and I will have a try at it if it will expedite things, but I do wish to say that Mr. Livingston made certain statements concerning the conduct of the Government counsel and the stipulation of facts, and I therefore would like to state, for the record, that on January 20th, 1954, the Regional Counsel's Office wrote to Mr. Livingston calling his attention to the Court's rule requiring a stipulation of facts and suggesting that such a stipulation be prepared and forwarded to the Government some time in March—in February—so that the Government would have a chance to check the facts and stipulate. I wish to state that I did not hear from Mr. Livingston until after I had served subpoenas on the petitioner and [158] McDonald Island Farms on the Thursday before the call of the calendar, and that I did not receive Mr. Livingston's draft of the proposed stipulation until after the call of the calendar on Monday of this week.

Now, I wish to state that at that time, even in the presence of other calendar business, I prepared a revised draft containing most of the material Mr. Livingston suggested and returned it to him within twenty-four hours of the time I received his draft, and the only reply I had from Mr. Livingston on that matter was that he would probably stipulate

(Testimony of George Schroeder.)

in open Court. He hadn't agreed with the revised draft of the stipulation.

Mr. Livingston: Now, it is quite evident that counsel is endeavoring to exploit, for the benefit of his side of the case, a subject which has been—which was discussed yesterday morning, and has been rediscussed today.

Mr. Nyquist: I am merely attempting to correct the record of Mr. Livingston's statement to the effect that Government counsel was uncooperative in attempting to stipulate.

Mr. Livingston: I say, and I challenge counsel to produce, the paper that he prepared, which will show what a limited scope it was.

The Court: Gentlemen, I think we have had enough of these mutual challenges, and let's get on with the trial of the case if we can. [159]

If Government's counsel believes he can obtain the evidence from this witness in a manner which will not involve the use of the contents of the documents under discussion, I will permit him to make the effort subject, of course, to any objections that may be made.

Q. (By Mr. Nyquist): Mr. Schroeder, at the conference of December 23rd, 1946, did you or other representatives of your company make any proposals with respect to the manner in which the rights in the Henning Tract were to be transferred from the then owners to the purchaser?

A. Yes, sir.

Q. What was your suggestion?

(Testimony of George Schroeder.)

A. Mr. Capocelli and I went over there to the office. I believe it was Mr. Livingston's office, at which time Mr. John Zuckerman and Mr. Maurice Zuckerman were present, and we presented our suggested form of deed to cover the—or document to cover the transfer to the Pacific Oil Company of the rights that John Zuckerman and I had agreed upon were to be transferred.

In other words, John and I—John Zuckerman and I had practically reached an understanding as to what the deal was, and we had to put it in writing in order to transfer the property interests. Somebody had to start it, and we submitted some papers to cover, I believe, both of the properties.

Q. My specific question was: What was your suggestion as to the manner of conveying the Henning Tract from its then owner, McDonald Island Farms, to the purchaser? That is, the route that the conveyance was to take, was it to be a direct conveyance or indirectly through some other corporation?

Mr. Livingston: I object to that on the ground it assumes something not in evidence, if I understood the question. He is asking the witness about a proposal with respect to the transfer of the rights under Henning Tract to be made by McDonald Island Farms, and the evidence shows that there was a deed dated December 21, 1946, in which those rights were transferred by McDonald Island Farms to Weyl-Zuckerman and Company pursuant to a dividend that was declared in kind on the same date.

(Testimony of George Schroeder.)

Mr. Nyquist: Your Honor, there was a deed dated December 21, recorded January 10th, 1947, and we are talking about a conference of December 23rd, 1946.

Mr. Livingston: But, under the law of California recordation has nothing to do with transfer of title. That is merely the manner that the transaction is presented to protect the purchasers for value.

The Court: Let's get this straight right here and now. At the time of that conference, December 23rd, 1946, had the deeds been executed either to Standard or to a nominee of Standard? [161]

The Witness: You are asking me that, sir?

The Court: Yes.

The Witness: I am sure there were no deeds executed to the Standard Oil Company on that day.

Q. (By Mr. Livingston): Or Pacific Oil?

A. Or the Pacific Oil upon that day.

The Court: Namely, that the transaction had not yet been consummated on December the 23rd?

The Witness: That is correct, sir.

The Court: In fact, the conversations on December 23rd, 1946, were conversations looking forward to the consummation of the transfer of title, were they not?

The Witness: Yes, sir. As I say, John Zuckerman and I had an understanding of what the basic deal was, and the purpose of the meeting was to get the papers to transfer.

Mr. Livingston: I believe the documents are dated January 11th, 1947, your Honor. I may be

(Testimony of George Schroeder.)

in error as to the date, but I think that is approximately——

The Court: Well, there is discussion about deeds dated December 21.

Mr. Livingston: That was a deed that was executed pursuant to the dividend which is under attack here, the dividend of the mineral rights.

Is that clear, or am I still confusing the Court?

The Court: I think I have your point. Thank you.

Mr. Nyquist: I will withdraw my previous question and ask you:

Q. (By Mr. Nyquist): At the time you went into this conference on December 23rd, 1946, whether you knew at that time that there had been a conveyance of the Henning Tract from McDonald Island Farms, Ltd. to Weyl-Zuckerman Incorporated?

A. I do not recall, sir, any knowledge of that at that time. We were talking with John Zuckerman, Maurice Zuckerman about buying the properties, the two properties, and I don't remember that we ever discussed who had it or how it stood or anything like that.

When I talked to John Zuckerman over the years about these properties we were talking about the properties, unless he would happen to mention the Henning Tract or the other one.

Q. My question specifically was, on December 23rd when you went into that conference, had you any knowledge in advance of that time that there

(Testimony of George Schroeder.)

had been this conveyance dated December 21st from McDonald Island Farms to Weyl-Zuckerman?

A. I don't recall any discussion——

The Court: Well, was it of any consequence to Standard at all what route these conveyances were to take, as long as Standard or its subsidiary would be the ultimate grantee? [163]

The Witness: It made no difference. We weren't too concerned.

The Court: It was a matter of no consequence to you?

The Witness: That is correct.

Q. (By Mr. Nyquist): At the time you went in to that conference of December 23rd, what was your intention, that there be a conveyance directly from McDonald Island Farms to Pacific Oil Company?

Mr. Livingston: May I have that question, please?

(Question read by the Reporter.)

Mr. Livingston: I can't see that is material, your Honor, and it calls for his conclusion, conclusion on the part of a third party.

Mr. Nyquist: Your Honor, the materiality is this: I am trying to show that this December 23rd conference, which is after the date of the conveyance from McDonald Island Farms, after the date the conveyance bears, but before it was recorded, the parties were still talking; that is, the Standard Oil went in to the conference on the assumption that they could get a—that there would be a direct conveyance from McDonald Island Farms to Pacific Oil,

(Testimony of George Schroeder.)

that Standard intended that the deal be that way, that it was Mr. Livingston's suggestion that the deal be put in the round-about form, and I also——

The Court: I don't think there has been any [164] testimony that Mr. Livingston made such suggestions.

Mr. Nyquist: Well, I want to first get in the fact that at this time they had not been apprized of any December 21st conveyance and the negotiations were still open at that time as to how the conveyances were to be made.

Mr. Livingston: But the witness testified a moment ago in answer to your Honor's question, as far as he was concerned, he didn't care what route the transaction took. All he wanted was to get the gas rights.

Mr. Nyquist: All right. At the time—I will withdraw my previous question.

Q. (By Mr. Nyquist): At the time you—At the December 23rd conference in 1946, did you make a —did you or Standard Oil Company make a suggestion or present a plan as to the route which the conveyance of the gas rights underlying the Henning Tract should take in being transferred to Standard Oil or to Pacific Oil?

A. I don't recall any distinction between the Henning Tract or the other parcel. These papers that we presented were designed—it was our suggestion of a way to consummate the deal so that we would get both of these properties.

The Court: Well, was it your understanding

(Testimony of George Schroeder.)

when you went into that conference of December the 23rd, that one of these tracts was owned by Weyl-Zuckerman and that the [165] other tract was owned by McDonald and whether you rightly or wrongly so understood, you nevertheless were proceeding on that basis and had drafted papers to effectuate a transfer of these respective tracts from each of the purported owners to Pacific Oil?

The Witness: I'm afraid that I don't remember with that amount of precision. I know that what we were trying to do was to acquire the two properties and I felt satisfied that the documents that we presented were grants that would have given to the Pacific Oil Company things that we wanted. I mean, that is what we submitted as a form to Mr. Livingston, and, as I remember, he didn't like that approach and we proceeded then to talk about putting certain modifications in the leases.

As I remember, the papers were a grant with certain reservations and you wanted to go a slightly different route, you wanted to submit your own papers. You threw out, in effect, the papers that we had suggested, and I couldn't tell you the name of the grantor, the grantee. I wasn't particularly interested in the—in that aspect of it. We wanted to buy these two properties, and that was the understanding that John Zuckerman and I had reached. We wanted those documents to come to us, and we suggested one form and Mr. Livingston suggested another form.

The Court: When you use the word "you" in

(Testimony of George Schroeder.)

your [166] testimony, you are referring to Mr. Livingston?

The Witness: Yes, I believe that is right.

Q. (By Mr. Nyquist): You have just—Excuse me. In your previous statement you said that you had prepared the documents in one form and Mr. Livingston in another form. Can you explain what differences there were—Well, that perhaps is subject to Mr. Livingston's objection. I will withdraw it.

Did Standard Oil or you ever indicate or state to the taxpayer or to any of the taxpayers' representatives that you preferred—that it made any difference to you whether you received title for the property from two transferors or from a single transferor?

A. I do not recall any such thing as that.

Q. Was there a further conference early in January of 1947 with respect to the form in which these conveyances were to be made?

A. As I remember, sir, we had more or less continuous discussions there for a couple of weeks between—around the Christmas holidays, between the time that these papers were first submitted by us and the time the transaction was consummated.

There were several little points that had to be cleared up. I remember we had some debate as to the location of the line cutting off a portion of the Henning Tract to the [167] southwest that was to be—with respect to which the Weyl-Zuckerman people were to keep the gas rights subject to the lease

(Testimony of George Schroeder.)

of the Standard Oil Company and discussion on the location of the contact point between the Eocene and cretaceous so that Zuckermans would have the gas royalty. I don't remember particularly what point was discussed on what day, but we had discussions.

Q. Mr. Schroeder, on January 8th, 1947, did Mr. Livingston, acting as representative for the taxpayers Weyl-Zuckerman, hand to you certain documents?

A. I do not recall the day on which Mr. Livingston gave me the documents.

Q. Did you write a memorandum on January 8th, 1947, in which you set forth the facts as you then knew them?

A. A memorandum dated January 8th——

Q. Just answer yes or no. Did you write a memorandum dated on that date?

A. I did not.

Q. Did you prepare—— A. I did not.

Q. What? A. I did not.

Q. Did you—Did someone under your supervision write such a memorandum?

A. Yes, sir. [168]

Q. And did you read it at the time?

A. I believe I did, yes.

Q. And did you know it to be correct at the time?

A. I believe it is correct. I believe it to be correct.

(Testimony of George Schroeder.)

Q. Would looking at that memorandum refresh your recollection in this matter?

A. Yes, sir.

Q. All right, I will then ask you to look at the last half of the memorandum dated January 8th, 1947. A. Where it reads, "We all"——

Q. Yes, just look at it and go through it. Read it to yourself. A. I have read it.

Q. Having read that, is your recollection refreshed in this matter?

A. I suppose so.

Q. I again ask you, on January 8th, 1947, did Mr. Livingston, acting as representative for the sellers, hand to you, as a representative of the buyer, certain documents?

A. My memorandum states—Our memorandum states that he handed them to me on that day, so I believe that he handed them to me on that day.

Q. But you have no present recollection?

A. No, sir. All during those periods, during that period of negotiations, what happened on the particular day [169] I am afraid I don't remember, sir.

Mr. Nyquist: Your Honor, in view of the fact that this witness has no present recollection on this matter, but this memorandum was prepared for his signature and by an employee under his direction and he knew at the time that the contents were accurate, I offer that memorandum in evidence. The memorandum which has been marked for identification, Respondent's Exhibit J for identification.

Mr. Livingston: I am not objecting.

(Testimony of George Schroeder.)

The Court: It may be admitted.

The Clerk: Exhibit J is admitted.

(The memorandum referred to, heretofore marked as Respondent's Exhibit J, for identification, was received in evidence.)

Mr. Livingston: I presume that counsel, in interrogating the witness, will call his attention to the second half of the memorandum. I don't suppose that the interrogation limits the introduction of the document to the second half, that was so identified. The entire document was in?

The Court: I didn't understand there was any limitation on that, Mr. Livingston, and your consent to its admission, I take it, was to the entire document?

Mr. Livingston: That is right.

Mr. Nyquist: So that the record may be clear on this one final point: [170]

Q. (By Mr. Nyquist): Mr. Schroeder, at whose suggestion were the conveyances put in their final form whereby the Henning Tract was conveyed first to Weyl-Zuckerman and then to Pacific Oil as distinguished from a direct conveyance?

Mr. Livingston: Well, if your Honor please, may I understand that question? Does he ask Mr. Schroeder whether anyone said to him that the mineral rights under Henning Tract should be transferred to—by McDonald to Weyl-Zuckerman and then by Weyl-Zuckerman to Pacific Oil? Is that the purport of the question?

Mr. Nyquist: The purport of the question is to

(Testimony of George Schroeder.)

bring out the party at whose instigation the conveyance was made by the indirect route rather than the direct route.

Mr. Livingston: Oh, no. Oh, no. That would be an improper question to ask this witness, at whose instigation it was done. The proper question is—he has told us what the conversations are. Now, you may ask him about a conversation but not ask him about instigation, suggestion, or conclusion of any kind.

Mr. Nyquist: I will withdraw that question.

Q. (By Mr. Nyquist): I will ask, Mr. Schroeder, if you have any recollection of any conversations with respect to the—on the subject, let us say, of the manner in which title to the Henning Tract [171] was to be transferred from McDonald Island Farms so that it would ultimately reach Pacific Oil Company?

A. I do not recall anything like that as such.

Q. Were you particularly concerned with the manner or the route that the property took in reaching Pacific Oil Company?

Mr. Livingston: Your Honor asked him that question and he said, "No." It is repetitious.

Mr. Nyquist: No further questions.

Cross Examination

Q. (By Mr. Livingston): Mr. Schroeder, you referred in one conversation, I believe it was December 12th, 1946, to a discussion involving the acquisition by the Standard Oil Company or its sub-

(Testimony of George Schroeder.)

sidiary of certain gas rights at that time and the obtaining of an option to acquire the gas rights of other—other gas rights under later date which you said was August 15th, 1947. Now, please identify to the best of your recollection, which gas rights—that is, under which tract or which part of McDonald Island were to be acquired currently and which were to be acquired pursuant to an option under date of August 15th, 1947?

A. The parts to be acquired currently was the McDonald interest, that is, the McDonald Island Farms parcel on the easterly portion of the island, and the part mentioned for [172] option to be acquired in August, 1947, was the westerly part, the Weyl-Zuckerman piece, the thing that is sometimes referred to as the Henning Tract.

Q. That is right. In other words, what you had —what you said was—with respect to the physical or geographical location of the rights and the—Is that right, is that correct so far?

A. Say it again, please.

Q. All right. What was said at that time had reference to the geographical location of the rights, is that correct?

A. What was said was that they were willing to sell at that time the piece of property that was being referred to as the McDonald Island Farms which was subject to the lease between the Standard Oil Company and the McDonald Island Farms as distinguished from the one that was held by the

(Testimony of George Schroeder.)

Standard Oil Company under the lease we called the Weyl-Zuckerman lease.

Q. And when you speak of the Henning, you refer to the McDonald Tract, do you not?

A. The piece of land under the McDonald Island Farms lease, that is right.

Q. Which was the McDonald Island Farm Tract, isn't that correct?

A. Yes, that is what it means. It says the McDonald [173] Island.

Q. Well, I don't think it does say that, but we just want to clarify it now. Now, the property that was subject to option was the gas rights underneath what is known as the Henning Tract?

A. That is right.

Mr. Livingston: That is right. May we have a short recess, your Honor? There may be some further questions, something further I might want to ask Mr. Schroeder.

The Court: Yes, we will have a short recess.

(Short recess.)

Mr. Livingston: No further questions, your Honor.

Redirect Examination

Q. (By Mr. Nyquist): Mr. Schroeder, referring to Respondent's Exhibit I, memorandum of January 28th, 1947, will you identify Mr. Felix T. Smith to whom that is addressed?

A. Felix T. Smith was chief counsel for the Standard Oil Company of California at that time, presently deceased.

(Testimony of George Schroeder.)

Mr. Nyquist: No further questions.

Mr. Livingston: That is all.

Mr. Nyquist: So you may know how this is progressing, your Honor, I have one other witness which I think will take ten or fifteen minutes——

You are excused, Mr. Schroeder. [174]

(Witness excused.)

Mr. Nyquist: I have two questions that I wish to ask of petitioner's witnesses that were put on yesterday. There are two points that I wish to pursue. I think I will call as my witness on this point Mr. Von Husen.

Whereupon,

JOHN VON HUSEN

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

Q. (By Mr. Nyquist): Mr. Von Husen, showing you Exhibit D, and in particular the ledger sheet, I am just asking you to read certain writing that is not particularly legible.

Was this prepared by you?

A. The bookkeeper in our Stockton office prepared this ledger sheet.

Q. Can you read to me the entry dated March 31, 1951 on that sheet?

A. "March 31, 1951, transferred from surface

(Testimony of John Von Husen.)

rights of tract, three two eight thousand, three two seven six nine," and this represents the surface rights of the McDonald Tract proper which had been kept in a separate account up to this point and were transferred into the combined land account March the 31st, 1951. [175]

Q. And the following line under the same date?

A. "Increment of McDonald Island value land to $175 per acre for a total amount of two eight eight thousand, nine forty-one eighty-one."

Q. And what does that represent?

A. That brought the book value of the 3800 acres of the McDonald Tract land which was then in our name to a total value of $175 per acre.

Mr. Nyquist: I have no further questions.

Mr. Livingston: No questions.

(Witness excused.)

Mr. Nyquist: Now, at this time I would like to ask the permission of the Court to recall Mr. John Zuckerman for cross-examination.

Mr. Livingston: No objection.

Whereupon,

JOHN ZUCKERMAN

recalled as a witness for and on behalf of the Petitioner, having been previously duly sworn, was further examined and testified as follows:

Further Cross Examination

Q. (By Mr. Nyquist): Mr. Zuckerman, do you recall the occasion of a conference in the office in

(Testimony of John Zuckerman.)

the Internal Revenue Agent's office, with respect to the 1946 and 1947 tax liability of [176] Weyl-Zuckerman?

A. Which revenue agent? Mr. Potthoff?

Q. No, I am referring to the agent Mr. Cummings. Mr. Potthoff is of the Appellate staff. I am referring to a conversation in the revenue agent's office. A. In his office?

Q. Mr. Ansel Cummings was the conferee representing the Government. A. What date?

Q. It was in 1950.

Mr. Livingston: What dates, please?

Mr. Nyquist: March 7, 1950.

A. I don't at the moment recall it.

Q. (By Mr. Nyquist): Do you have any recollection of attending such a conference with Mr. P. K. Webster, Mr. Benton C. Coit, Mr. John Von Husen accompanying you?

A. Well, I went to one conference with those men.

Q. I show you Respondent's Exhibit E, the Protest of Weyl-Zuckerman Company, dated January 5, 1950, and ask you whether you have any recollection of having seen that document previously?

A. Well, I have seen many documents in connection with this case and this could be one of them.

Q. I suggest to you that that document was—covered [177] the subject matter of that conference and was a protest filed in advance of the conference stating the position of Weyl-Zuckerman at that

(Testimony of John Zuckerman.)

time, and ask you whether, on looking at it, in view of my statement, you recall it to be such?

Mr. Livingston: Well, I am having a little difficulty, if your Honor please, in following counsel's suggestion. If I understood him correctly, he says this document was prepared after a conference and that this document, therefore, can constitute a memorandum of what occurred at a previous conference. Is that the point?

Mr. Nyquist: No, your Honor. This is a protest which was filed in advance of a conference in the revenue agent's office stating the position of the taxpayer, and this was the subject matter—covered the subject matter of the conference which was held a few months thereafter.

Mr. Livingston: And the question is whether, by reading this, it will refresh his recollection as to what occurred afterwards?

Mr. Nyquist: No, whether it will refresh his recollection as to the nature of the document and the purpose for which it was prepared.

Mr. Livingston: Well, the document speaks for itself as a Protest, Mr. Nyquist.

Mr. Nyquist: It is a protest.

Mr. Livingston: All right, then, that is settled [178] without having the witness testifying about it.

I agree. I stipulate it is a Protest. I can stipulate likewise for the purpose for which it was prepared because we all know. That is obvious.

Mr. Nyquist: And will you stipulate that it was used at that conference of March 7th, 1950?

(Testimony of John Zuckerman.)

Mr. Livingston: You mean, was it physically present in the room?

Mr. Nyquist: Yes.

Mr. Livingston: I don't know.

Mr. Nyquist: That is what I am trying to get at through this witness.

Mr. Livingston: The question, as I understand it, was that document physically present in the room at a meeting to which Mr. Nyquist refers.

The Witness: I don't know.

Q. (By Mr. Nyquist): At that conference was there a discussion of some of the facts with respect to the transactions that have been in issue in this proceeding here? A. I don't know.

Q. I am going to read a sentence from this document and then ask you a question concerning it. I am reading it from page 3 of Exhibit E:

"After the transfer of the property * * *" and the [179] previous paragraph refers to the transfer of the property of the Henning Tract to McDonald Island by Weyl-Zuckerman, "* * * the transfer of the property had been made and recorded, the taxpayer was approached by a third party desiring to purchase all the known mineral rights located on McDonald Island."

I am going to ask you whether you recall any statements being made at this conference in the Revenue Agent's office on the subject of that sentence that I just read?

A. I don't remember.

(Testimony of John Zuckerman.)

Mr. Livingston: It is improper—well, that is the answer, let it go.

A. I don't remember.

Mr. Nyquist: I am going to read the following sentence——

Mr. Livingston: May I interrupt just a moment? I intended to put in an objection before the answer, but I came too late. It is not proper interrogation of a witness to ask him whether certain things were said at a particular meeting and to use a document, and read from a document for that purpose or even refer to that document. The proper question was this said, was this or that said at that meeting. The witness has no relation to the document, it wasn't prepared by the witness——

The Court: Are you making an objection?

Mr. Livingston: Yes.

The Court: To what? Is there a pending question you are objecting to?

Mr. Livingston: Yes, the question.

The Court: Mr. Reporter, is there a question pending?

(Record read by the Reporter.)

Mr. Livingston: I jumped the gun because it was obvious he was going to ask the same type of a question. I am going to withdraw my objection at this time and I am going to ask the Court to have it repeated after the question is propounded.

The Court: I don't know what the question is.

Q. (By Mr. Nyquist): At this time I am going to read one more sentence from the Protest pre-

(Testimony of John Zuckerman.)

pared by the taxpayer and submitted to the Bureau of Internal Revenue, Exhibit I, "The third party, Pacific Oil Company, was interested only in the purchase of all the known mineral rights on the island as a whole for the purpose not only of extracting but also injecting natural gas for storage purposes if such occasion should arise in the future; * * *"

I am going to ask you whether you have any recollection of that topic being discussed at the conference of March 7th, 1950? [181]

Mr. Livingston: No objection.

A. Well, not having a recollection of the conference I would have a difficult time recollecting that discussion taking place. However, those are the facts as I knew them.

Q. (By Mr. Nyquist): These are the facts as you knew them?

A. That Pacific Oil Company was only interested in buying the entire gas rights on McDonald Island.

Q. But you have no recollection of making that —of a discussion of that fact at a conference of March 7th, 1950? A. No, sir.

Q. Do you have any recollection of a discussion of any of the business dealings—I will withdraw that. I will rephrase it.

Do you have any recollection of any discussion at that time or of making any statements at that time with respect to the obligation on the part of the McDonald Island Farms, Ltd. to pay off the principal amount of a bank loan on a basis that was de-

(Testimony of John Zuckerman.)

termined by the amount of income of McDonald Island Farms? A. No.

Q. You have no recollection of any such statements—of any statements being made on that point at the conference? A. No.

Mr. Nyquist: No further questions, your Honor.

Mr. Livingston: No questions.

(Witness excused.)

Mr. Nyquist: I have one further witness, your Honor.

At this time I will call Mr. Ansel Cummings. Will you take the stand, Mr. Cummings?

Whereupon,

ANSEL CUMMINGS

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you have a seat, sir, and state your name and address, please?

The Witness: Ansel Cummings, employed by the Bureau of Internal Revenue, U. S. Treasury Department.

Direct Examination

Q. (By Mr. Nyquist): Mr. Cummings, what was your occupation in 1950?

A. I was a conferee in the office of the Internal Revenue Agent in Charge.

Q. Located where? A. In San Francisco.

Q. Did you hold a conference in the case of

(Testimony of Ansel Cummings.)

Weyl-Zuckerman and Company? A. I did.

Q. On March 17th, 1950? [183]

A. Correct.

Q. Could you tell me who was present at that conference?

A. Mr. Webster, Mr. Coit, Mr. Zuckerman, and Mr. Von Husen.

Q. Will you identify Mr. Webster? That is a new name here.

A. Mr. P. K. Webster was a certified public accountant who was representing the taxpayer.

Q. And Mr. Coit?

A. Mr. Coit was an associate in the proceedings. He was a CPA for Haskins and Sells, as I recall.

Q. Will you tell us the subject of that conference?

The Court: Which Mr. Zuckerman were you referring to?

The Witness: Mr. John Zuckerman, who at the time was President of the Petitioner, at that time taxpayer.

Q. (By Mr. Nyquist): Are you referring to Mr. John Zuckerman or Mr. Maurice Zuckerman?

A. The name was John Zuckerman.

Q. The name was John Zuckerman?

A. Yes.

Q. The gentleman who is sitting here in the Court room? (Indicating Mr. John Zuckerman.)

A. I believe that is he, yes.

Q. What was the subject of that conference?

A. The subject of the conference was based upon

(Testimony of Ansel Cummings.)

a protest which they had filed with respect to a certain mineral right previously owned by the Petitioner, transferred to a wholly-owned subsidiary and then later transferred back to Petitioner.

Q. May I ask you to state in a more general way the broader subject of the conference; that is, in terms of what was to be the—the tax liability involved, the years, and so forth?

A. Oh, the years involved were 1946 and '47, specifically, and the amount of the tax I don't recall.

Q. Now, you made some statements regarding a protest being the subject of the conference. I show you Exhibit E and ask you if that is the document that you referred to? A. That is.

Q. You will note that Exhibit E contains certain allegations of fact, and I ask you whether there was a discussion of the facts of this case at that conference? A. There was a discussion.

Q. Was there a discussion of the matter of the circumstances leading up to the sale by the taxpayer of a certain—of certain oil and gas rights to Pacific Oil Company in January of 1947? [185]

A. Yes, there was a discussion.

Q. Can you tell me what was said at that time about the circumstances leading up to that sale?

A. Well, initially the Petitioner had transferred this mineral right to its wholly-owned subsidiary——

Mr. Livingston: Pardon me, is this—I would like to know whether the witness is relating a conversa-

(Testimony of Ansel Cummings.)

tion now, and if so, who was the one that made the statement that he is now relating?

The Witness: This—I am not relating any conversation, I am relating the circumstances of the conference.

Mr. Livingston: Well, then, I object to the—I object that the answer is not directed to the question. The question calls specifically for a conversation.

Q. (By Mr. Nyquist): Mr. Cummings, the Court is already familiar with the background circumstances with the transfer of the Henning Tract to the subsidiary, and consequently that background is not necessary in answering any specific question about the circumstances leading up to the sale to Pacific Oil in January of 1947.

A. Well, it was discussed that after the subsidiary had acquired these particular rights the taxpayer was approached by a third party who desired to buy all of the mineral rights on both pieces of property. [186]

Q. Do you recall which of the persons present at the conference made that statement?

A. Not definitely, but I am of the opinion it was Mr. Webster who was the general spokesman for the four, representing the taxpayer, including the taxpayer.

Q. And when you said "the taxpayer," did you refer to Mr.—were you referring to the corporation or to Mr. Zuckerman personally in that sense?

(Testimony of Ansel Cummings.)

A. The corporation was the taxpayer in that instance.

Q. And were Mr. Von Husen and Mr. John Zuckerman present at the time that statement was made?

A. They were present throughout the entire hearing.

Q. And was the subject of the manner of re-conveying—of conveying the property—I will be more specific.

Was the subject of the route taken by the conveyance of the gas rights under the Henning Tract from McDonald Island Farms to Weyl-Zuckerman and then to Pacific Oil Company discussed?

A. Yes.

Q. Was a reason given for the conveyance taking that route? A. Yes.

Q. Will you state that reason that was given?

A. The reason given at the time was that the purchaser desired to obtain both mineral rights from one owner, and at [187] the same time.

Q. Was the subject of a bank borrowing by McDonald Island Farms with the surface rights of McDonald Island as security mentioned at the conference? A. It was.

Q. Was any mention made at that time of any obligation on the part of McDonald Island Farms to make payments on principal in proportion to or measured by the income of McDonald Island Farms? A. No, there wasn't.

Mr. Nyquist: I have no further questions.

(Testimony of Ansel Cummings.)

Cross Examination

Q. (By Mr. Livingston): What was the date of this conversation, please?

A. March 9th, 1950, is my recollection.

Q. And I believe you said that the John Zuckerman that was present at the conversation was the President of Weyl-Zuckerman and Company, is that right? A. That's my recollection.

Q. Have you any documentary evidence to support that statement?

A. It should be—I don't know that there definitely is any unless it is in the Protest.

Q. Well, will you examine the Protest and see whether he is so described? [188]

(Witness examines document.)

A. It doesn't show in here, no.

Q. It doesn't show who the president is?

A. That is correct.

Q. And then, so that the identity of John Zuckerman as President of the Weyl-Zuckerman Company is something that you recall from that conversation, is that right?

A. My recollection is that he was discussed as being the then president at the date of conference hearing. Whether or not he was prior to that, I do not know.

Q. But on—And do you recall who it was that said in substance, at that time, "John Zuckerman is today the President" or "is now the President of Weyl-Zuckerman and Company"?

A. I don't recall that specifically at all.

(Testimony of Ansel Cummings.)

Q. You don't recall who said it? Did you make any notes of that conference?

A. I did make notes at the time, yes.

Q. Where are they?

A. They are destroyed.

Q. How long did you keep them?

A. Until December of 1952.

Q. And is it customary to destroy notes of conferences?

A. Well, there is no established custom. The incidents surrounding this is that we were removed from our old quarters, my job was—I was transferred to a different [189] position and most of the files were destroyed such as working papers, at that time. They were not carried over.

Q. Did you make any report at any time based upon the contents of your notes? A. I did.

Q. And may I see that, please?

A. The report is in the custody of Mr. Nyquist.

Mr. Livingston: I would like to see it, if I may.

Mr. Nyquist: Your Honor, this report is a report made by a revenue agent to his superior. I see no occasion for furnishing the taxpayer with the report. I don't believe it has any authority for furnishing him with it.

The Court: What are you trying to get at, Mr. Livingston?

Mr. Livingston: I am trying to find out, to cross-examine the witness for the purpose of determining the accuracy of his recollection.

He has told us that—he has undertaken to tell

(Testimony of Ansel Cummings.)

us, from his recollection apparently, what was said in a particular meeting in 1950 which is some four years ago. It now develops he made notes of that conversation and he has destroyed the notes for reasons that are quite adequate, but that those notes are embodied, or rather the substance of the notes are embodied in a report. Therefore, if the report was made, that would be—would indicate much more accurately the [190] exact details of the conversation and would assist us materially in determining what was actually said at the meeting he has described.

I assume if the notes were here we could have access to them.

Mr. Nyquist: Your Honor, I wish to correct the record in one point. The witness, I don't believe, stated anything about his notes being embodied in the report. He testified he made a report. I don't believe——

Mr. Livingston: Let me ask the question a second time and see if I made a mistake.

Q. (By Mr. Livingston): Mr. Cummings, didn't you tell me a little while ago that on the basis of these notes you made a report?

A. I answer "Yes" to your question. I don't recall exactly what your question was, but this report is founded upon the notes taken during the hearing, yes.

Q. Yes.

A. Plus other occurrences which I retained in my mind.

(Testimony of Ansel Cummings.)

Mr. Livingston: "Yes." That is it. I submit the question, your Honor.

The Court: Mr. Nyquist, are you willing to let Mr. Livingston examine the report?

Mr. Nyquist: Yes, I am, your Honor.

I would be willing to stipulate that it may be put [191] in evidence.

Mr. Livingston: May I see it?

Mr. Nyquist: Don't mark it up, please.

Mr. Livingston: I will rub the few marks I make out.

Q. (By Mr. Livingston): Now, in that conversation—in the conversation of March 7th, 1950, was anything said on the subject of the transfer of the Henning Tract including both the surface rights and the mineral or gas rights to McDonald Island Farms, Ltd.? A. It was discussed.

Q. The subject was mentioned? A. Yes.

Q. And was the fact mentioned in that conversation that the consideration specified or stipulated for that transfer was an amount equal to the cost, the initial cost of Henning Tract?

A. I don't know that it was particularly worded that way, no. The amount of money was the definite statement.

Mr. Nyquist: Your Honor, I object to this course of cross examination. This is an obvious attempt to bring out certain hearsay evidence and not a matter of cross-examining the witness to test his recollection or anything of that sort.

(Testimony of Ansel Cummings.)

The Court: What is the purpose of the examination?

Mr. Livingston: To ascertain everything that was said material to this litigation at the meeting of March 7th, [192] 1950. The witness has testified that he recalls certain things having been said. That makes it proper for me, on cross-examination, to inquire whether other things were said, and if so, to bring them out so that the entire conversation can be revealed.

Any time that a witness testifies to a conversation on cross-examination, as I view it, it is proper to investigate all the statements made at that time, at that same conversation, which are material to the subject.

Mr. Nyquist: Your Honor, this was a—quite probably was a lengthy conference at which there were a number of topics discussed. I asked this witness specific questions about specific topics. We will be here all day if we are allowed to try the case to that conference.

The conference, I don't think, should be regarded as a single conversation for admitting the whole conversation.

The Court: Mr. Livingston, are you challenging the witness' recollection or the accuracy of his statement of what he remembers, is that the purport of the questions that you are putting to him?

Mr. Livingston: I don't say that I challenge his recollection, I am merely trying to——

The Court: You want to probe it?

(Testimony of Ansel Cummings.)

Mr. Livingston: Probe it, that is it. Challenge. Means that I am indicating to the Court that I disbelieve [193] him. Now, it may be that I don't agree with his version of the conversation.

The Court: Well, I will let you, within a reasonable limit, pursue the matter but not for the purpose of establishing the truth or falsity of the content of any statements which he——

Mr. Livingston: Oh, no. Oh, no. I have no such intention.

The Court: You don't seek to produce any hearsay evidence through this witness?

Mr. Livingston: Oh, no.

The Court: Well, for the limited purpose of probing the accuracy of his recollection I will permit you to proceed within reasonable limits.

Mr. Livingston: All right, now, what is the pending question?

(Question read by the Reporter.)

Q. (By Mr. Livingston): Let's see if we can stimulate your recollection in that respect. What was said about the price—what, if anything, was said about the price at which Henning Tract was transferred to McDonald Island Farms, Ltd. by Weyl-Zuckerman and Company?

A. Well, the transaction was discussed.

Q. Now listen, please. Bear in mind the question. [194] What was said as to the price, if anything? Try to answer that specifically, if you can.

A. Well, I only remember specifically that the money, the amount of money involved, as to any

(Testimony of Ansel Cummings.)

particular part of the specific discussion at this time I don't recall.

Q. You have no recollection on that subject? In other words, don't you recall that it was stated that the price was—can't you recall that it was stated at that conference that the price was $338,375?

A. I recall that the price was stated, yes, if that is the price.

Q. All right. Now, do you recall now—Now then, don't you recall that it was stated that that price represented the original cost of Henning Tract?

A. I don't recall that that was particularly stated in the conference, no.

Q. I am not asking you whether you recall it was particularly stated. My question is, was it stated at all, particularly or otherwise?

A. I don't recall.

Q. Is it your recollection that someone said at that conversation that the prospective buyer of the gas rights on the entire island wanted to purchase those rights from a single owner?

A. That is my recollection. [195]

Q. Yes. Well, now, I call your attention to the following statement that is contained in your report. I will show it to you before I propound the question.

(Counsel then handed the document to witness.)

"Taxpayer further states that after the transfer of the property had been made and recorded, the taxpayer was approached by a third party desiring to purchase all the known mineral rights located on

(Testimony of Ansel Cummings.)

McDonald Island, and that the third party, Pacific Oil Company, was interested only in the purchase of all the known mineral rights on the island as a whole for the purpose of not only extracting but also injecting natural gas for storage purposes."

Will you kindly read that?

(Statement read by the witness.)

Q. Now, having read that and having in mind that this is a statement prepared by you from the original notes of the conversation, I will ask you if it is not a fact that what was said at that conference was that the Pacific Oil Company was interested only in the purchase of all of the mineral rights on the island? Was that stated at the conference?

A. Not in that particular way, no.

Q. Was it stated in this particular way: "Taxpayer further states that after the transfer of the property had been made and recorded, the taxpayer was approached by a third party desiring to purchase all the known mineral rights [196] located on McDonald Island, and that the third party, Pacific Oil Company, was interested only in the purchase of all the known mineral rights on the island as a whole for the purpose of not only extracting but also injecting natural gas for storage purposes."

Q. My question is, was it stated in that particular way?

A. Not necessarily. That would be a summation of the various conversations that we had in connection with it.

(Testimony of Ansel Cummings.)

Q. Well, do you deny——

A. That would be the result.

Q. Do you deny——

A. That would be the determination.

Q. Pardon me. Do you deny that in the course of that conversation Mr. Webster or somebody on behalf of Weyl-Zuckerman and Company stated in substance what you have recorded in this statement? A. Do I deny what?

Q. Do you deny that in the course of that conversation Mr. Webster or someone else speaking for Weyl-Zuckerman and Company stated in substance what I have just read to you from this report?

A. Well, I couldn't deny it. I put it in my report.

Q. So you admit that he did make that statement in substance? [197]

A. What statement in substance, specifically?

Q. Read it again, please.

(Counsel handed document to witness.)

A. I would like for you to rephrase your question so I can get at it, exactly what you mean.

Q. Read it and tell me what there is about the question that confuses you.

A. What statement in substance? That is what I want to know, what statement?

Q. The statement that appears and as reported, which I have read to you on three different occasions now.

Q. You want to know if Mr. Webster himself made this statement?

(Testimony of Ansel Cummings.)

Q. Mr. Webster or anybody else speaking on behalf of the taxpayer, Weyl-Zuckerman and Company.

A. The way I will answer that is this: This did come out of the conference hearing on this matter, yes. It was not one sentence and it may have been discussed at various times throughout the conference, but that is the conclusion that I have derived from that conversation, yes.

Q. By the way, this transferring an asset by a subsidiary—Pardon me.

When a parent company makes a transfer of an asset to the subsidiary, is it customary to transfer that asset at cost? [198]

Mr. Nyquist: Objection, your Honor. This is not proper cross examination. It has nothing to do with the recollection of this witness and also calls for a conclusion of the witness as to what is proper.

The Court: Sustained.

Mr. Livingston: That is all.

Mr. Nyquist: That is all. Respondent rests, your Honor.

Mr. Livingston: We rest, your Honor.

The Court: Before I announce the times for briefs, I would like to call to counsel's attention one aspect of this case that still troubles me, and I hope the briefs may clear it up.

There was testimony with respect to the form in which the transfer to Standard's nominee ultimately took. That is, that the mineral rights under the Henning Tract were routed indirectly from Me-

Donald to the petitioner and then to the nominee of Standard. I don't quite understand just what the Government is attempting to prove in that connection.

If the transfer were made directly by McDonald to Standard, to Standard's nominee, I can't understand how there would be any capital gain at all that would be applicable to this petition because it would be the sale that would have been made by McDonald and not by this Petitioner. So then, if the transaction is isolated and, by the transaction I am [199] referring to the events occurring in December and January of 1946 and '47, the events of that transaction are telescoped, I am not quite sure where that gets the Government, because it would seem to me that if the Henning Tract were treated as remaining in McDonald, I don't see where there is any deficiency against this petitioner.

Now, it seemed to me that the crucial factual matter to be considered here is whether—or rather, is the nature of the transfer in July of '46, I think it was——

Mr. Livingston: June, your Honor.

The Court: June of '46 to McDonald. I think the essence of the case, as I see it, at this point, I would like your briefs to undertake to clarify it for me, is whether or not that transfer of June of '46 was made with the intention that the Henning Tract be present only for a transitory period, in McDonald, to be pulled back again into the Petitioner for purposes of ultimate disposition, so that it seems to me that the crucial question is not so much what hap-

pened in December and January as what the purpose of the transfer in June of '46 may have been, and I am not asking for any argument of counsel at this point on it.

Perhaps they will undertake to clarify it in briefs unless counsel desires to make a very short statement.

Mr. Nyquist: I might just make a word of explanation on that point, your Honor. [200]

We have viewed the case, I believe, as you have outlined it there. The importance of the transfer in December of '46 or January of '47, the importance of the testimony on that point is—the respondent put in, is for disproving any contention the petitioner might be making as the only reason this got back to Weyl-Zuckerman Company is because the buyer, Standard Oil, insisted upon it.

The Court: That is sort of a rebuttal type testimony rather than the foundation for your case.

Mr. Nyquist: Our case is on the original transfer to the subsidiary under circumstances when a sale of the tract was pretty obviously contemplated, and that the testimony of the witness regarding reasons for transfer of the surface rights in no way touched upon transferring the gas rights to the subsidiary and remaining in the parent.

The Court: I just called this to your attention and it may be dealt with in the briefs.

Petitioner's brief is due within forty-five days, the Respondent may reply thirty days thereafter, and the Petitioner may have twenty days in which to answer the Respondent.

Mr. Nyquist: May I ask for forty-five days, your Honor? We are on the West Coast. It takes us almost a week to get their brief, and then we have mailing delays as well as—and the fact that this is a complicated factual issue, [201] it will require a lot of cross-referencing and a lengthy transcript.

The Court: Well, it is my practice to allow only thirty days. If you find that insufficient, I will entertain a motion for an extension of time at the appropriate time.

Mr. Nyquist: Yes, your Honor.

Mr. Livingston: I will try to make a note on my office record to let Mr. Nyquist have a copy of my brief when it is mailed. I think I have done that in the past.

The Court: That is customary, and I believe it might expedite matters.

Mr. Livingston: The last case we had together it was done.

Mr. Nyquist: I appreciate that, your Honor. Unfortunately, I am not able to reciprocate because my brief has to be reviewed in Washington before it is in final form.

May I ask also, your Honor, may we be given permission to withdraw any exhibits we may have introduced that we wish to substitute photostats for?

I am covering it in general.

The Court: You may do so, except I would like, as far as possible, that the originals be left with me for the period during which I must consider them. If you wish to withdraw them temporarily for the

purpose of obtaining photostats, that is perfectly all right, but I would like the originals [202] returned so that I might have them to work with, when I come to study the transcript in the case.

Mr. Nyquist: Thank you, your Honor.

Mr. Livingston. The only question that arises in that case, would you like the minute book of the McDonald Farms to stay here?

If so, we are quite willing that it do so.

The Court: Well, that is a rather bulky document and only two pages of that minute book are involved. Perhaps, as to that, it would be better to withdraw the book and substitute photostatic copies of the two pages. But, I ask counsel to make sure that the photostats are legible.

Mr. Livingston: We mail those to Washington, the photostats?

The Court: The Clerk will give you the instructions.

(Whereupon, at 12:40 p.m., the hearing was closed.)

[Endorsed]: T.C.U.S. Filed April 5, 1954.

[Endorsed]: No. 14785. United States Court of Appeals for the Ninth Circuit. Weyl-Zuckerman & Company, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of Record. Petition to Review a Decision of The Tax Court of the United States.

Filed: June 6, 1955.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 14785

WEYL-ZUCKERMAN & COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Defendant.

PETITIONER'S STATEMENT OF POINTS

Henning Tract and McDonald Tract are farming properties located in the Delta Region of the San Joaquin River in San Joaquin County, California, and together comprise an island in the Delta known as McDonald Island. A slough runs through the island and forms the dividing line between the two tracts.

Prior to March 13, 1946, the ownership of said land was divided as follows: Petitioner owned in its entirety the Henning Tract. The McDonald Island Tract was owned by McDonald Island Farms Limited, hereinafter referred to as McDonald, Ltd., and the stock of this corporation, in turn, belonged one-half to Holly Sugar Corporation, hereinafter referred to as Holly, and one-half to petitioner.

On March 13, 1946, McDonald, Ltd., as a result of the insistence of Holly, declared a dividend in kind of the mineral rights in McDonald Tract and petitioner and Holly each received an undivided one-half interest in said rights. At the same time, Holly gave petitioner an option to purchase Holly's one-half interest, and on June 5, 1946, petitioner exercised said option, thereby becoming the owner of all the mineral rights of McDonald Tract.

On March 13, 1946, petitioner purchased from Holly the latter's one-half interest in the shares of stock of McDonald, Ltd. In order to make said purchase, it was necessary for petitioner to arrange for a substantial loan, and petitioner borrowed money from the Bank of America as a temporary expedient. In order to place the loan on a long-term basis, it was necessary to give as security the entire island, including both Henning Tract and McDonald Tract. This presented two problems: first, one of the corporations must be selected as the owner and grantor to be named in the deed of trust; and second, the extent of the security must be negotiated. For various business reasons established by the evidence, McDonald, Ltd. was chosen to act as the borrower.

Accordingly, on June 27, 1946, petitioner executed a grant, bargain and sale deed in the customary form, of Henning Tract, to McDonald, Ltd. and McDonald, Ltd. thereby became the owner of Henning Tract. McDonald, Ltd. executed a promissory note for $720,000 to Bank of America, together with a deed of trust of McDonald Island, excepting the mineral rights therein. The proceeds of the loan were used to pay for the property acquired from petitioner (which, in turn, paid off its obligations to the Bank of America) and to remove various encumbrances so as to provide a clear title to the two tracts comprising the island.

The mineral rights to both tracts of land had previously been leased to Standard Oil Company, and said leases provided for royalty payments. It was to the advantage of McDonald, Ltd. to reserve these royalties rather than to assign them as part of the security for the loan. The Bank acquiesced and consequently, as above stated, the deed of trust hypothecated only the surface rights in the island.

As a part of the same transaction, McDonald, Ltd. agreed in writing with the Bank of America that annual payments of $28,800 on account of principal of the loan would be made to the Bank, and that in addition thereto there would be paid on account of principal a sum equivalent to the difference between $28,800 and 35% of the net profits of the corporation for the prior fiscal year; "net profits" here used meaning profits before depreciation but after provision for income taxes.

Subsequent to the transfer of the properties to

McDonald, Ltd. and in July of 1946, there was discussion between petitioner and Standard Oil Company for sale of the gas rights in said property. Standard Oil Company had previously in November of 1945 made an offer of $500,000 which had been rejected, and the subject of sale of the gas rights had not again been mentioned until July of 1946. Thereafter, on December 12, 1946, a meeting was held between John Zuckerman, representing petitioner, and Schroeder, representing Standard Oil Company, at which an agreement was reached on a figure of $650,000 as the price of the gas rights (subject to some adjustments) and eventually the sale was consummated to Pacific Oil Company, a subsidiary of Standard Oil Company, as the buyer.

At the time of said sale, McDonald, Ltd. was the owner of Henning Tract, including the surface and mineral rights therein, as appears above. By reason of the agreement collateral to the deed of trust, as above stated, if McDonald, Ltd. had conveyed the gas rights in Henning Tract direct to the buyer, McDonald, Ltd. would have received a net profit and would have been compelled to make a payment to the Bank of America in the amount of approximately $50,000 on account of principal of the loan of $720,000, in addition to the annual amortization requirements. McDonald, Ltd., needed all available cash and, therefore, on December 21, 1946, in order to avoid the penalty, and in preparation for the consummation of the sale, McDonald, Ltd., declared a dividend in kind of the mineral rights in Henning Tract to petitioner as its sole stockholder. There-

upon, a deed of mineral rights bearing date December 21, 1946, was executed by McDonald, Ltd., to petitioner and was recorded January 10, 1947. Consequently, petitioner was the owner of the mineral rights in both Henning Tract and McDonald Tract and was in a position to make the conveyance to Pacific Oil Company of mineral rights in Henning Tract.

The conveyance of the mineral rights in Henning Tract by McDonald, Ltd. to petitioner, pursuant to said dividend, was made as the law requires (Section 115j, Revenue Code) on the basis of the fair market value, which was ascertained to be $230,000. This value represented the proportionate share of the Henning Tract rights with respect to the purchase price to be paid by Pacific Oil Company for the rights in the entire island comprising both McDonald and Henning Tracts. After deducting the dividends received credit of 85%, the balance was taxed at the normal and surtax rates amounting to $13,110. This, together with taxes on other income, was paid by petitioner in 1947. The portion of the sales price received by petitioner from Pacific Oil Company for the gas rights in Henning Tract was the same amount as that used for determining the income received by petitioner as the result of the dividend; consequently, there was no capital gain or loss in the sale of the Henning Tract gas rights to Pacific Oil Company.

On the basis of the foregoing facts, it follows that the purpose in conveying Henning Tract to McDonald, Ltd. was an ordinary business purpose and

there was no reason why it should have occurred to anyone that only the surface rights should be conveyed to McDonald, Ltd. There is no evidence that such an idea was entertained. On the other hand, there is ample evidence that the transaction took place in the ordinary course of business without any ulterior purpose or plan to frustrate taxation.

Hence, the Commissioner erred in levying a deficiency against petitioner and the Tax Court erred in affirming the deficiency.

There is no evidence that the conveyance was a subterfuge or that petitioner's purpose from the beginning was to step up the cost basis of the rights in Henning Tract and by that means reduce the capital gain on a subsequent sale thereof.

There is no evidence that a possible sale to Standard Oil Company was contemplated at the time of the conveyance of Henning Tract by petitioner to McDonald, Ltd., nor that said conveyance was made in anticipation of a sale to Standard Oil Company and as a step in a program to accomplish a sale in such manner as to avoid or reduce taxes.

There is no evidence that at the time of the conveyance of Henning Tract to McDonald, Ltd., petitioner planned or intended to have the mineral rights therein reconveyed to it.

The evidence shows without conflict that the conveyance of Henning Tract in its entirety was in good faith and for a genuine business purpose.

The findings of fact do not justify the conclusion of the Tax Court that at the time of the conveyance

of Henning Tract by petitioner to McDonald, Ltd., petitioner contemplated a possible sale to Standard Oil Company.

The findings of fact do not justify the conclusion of the Tax Court that said conveyance to McDonald, Ltd., was made in anticipation of a sale to Standard Oil Company or as a step in a program to accomplish the sale in such manner as to avoid or reduce taxes.

The findings of fact do not justify the conclusion of the Tax Court that at the time of the conveyance of Henning Tract to McDonald, Ltd., petitioner intended to have the mineral rights therein reconveyed to it.

The findings of fact do not justify the conclusion of the Tax Court that the conveyance to McDonald, Ltd., was a subterfuge or that petitioner's purpose from the beginning was to step up the cost basis of the mineral rights in Henning Tract and by that means reduce the capital gain on a subsequent sale thereof.

Dated: June 23, 1955.

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[Endorsed]: Filed June 24, 1955. Paul P. O'Brien, Clerk.